S. HRG. 99-466

OLDER AMERICANS PENSION BENEFIT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON AGING

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 1427

TO PROHIBIT THE SUSPENSION OF AN EMPLOYEE'S BENEFIT ACCRUED UNDER A RETIREMENT PLAN SOLELY BECAUSE OF AGE BEFORE ACCRUING THE MAXIMUM NORMAL RETIREMENT BENEFIT

OCTOBER 17, 1985

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CONTENTS

STATEMENTS

Thursday, October 17, 1985

Page

Guildroy, Jack, member, National Legislative Council, American Association of Retired Persons, accompanied by David Certner, AARP legislative staff.... 105
  Prepared statement 108
Losk, Norman S., chairman, Pension Committee, American Academy of Actuaries; Robert W. Kalman, associate, William M. Mercer-Meidinger, Inc., and Emily S. Andrews, research director, Employee Benefit Research Institute ... 54
  Prepared statement of Mr. Losk 57
  Prepared statement of Mr. Kalman 65
  Prepared statement of Ms. Andrews 88
National Rural Electric Cooperative Association, prepared statement.... 123
Rinaldo, Hon. Matthew J., a Representative in Congress from the State of New Jersey, prepared statement.... 3
Thomas, Clarence, Chairman, Equal Employment Opportunity Commission 6
  Prepared statement 8
Silvestri, Joseph M., general attorney, J. C. Penney, Co., on behalf of ERISA Industry Committee, accompanied by John M. Vine, Esq., Covington & Burlington; and Herbert Liebenson, President, National Small Business Association.... 27
  Prepared statement of Mr. Silvestri.... 30
  Prepared statement of Mr. Liebenson.... 49
Walker, David M., Deputy Assistant Secretary of Labor, Department of Labor, prepared statement.... 130

ADDITIONAL MATERIAL

Questions and answers:
  Responses of Mr. Thomas to questions submitted to him by Senator Grassley.... 25

OLDER AMERICANS PENSION BENEFIT ACT

THURSDAY, OCTOBER 17, 1985

U.S. SENATE,
SUBCOMMITTEE ON AGING,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:10 a.m., in room SD-628, Dirksen Senate Office Building, Senator Charles E. Grassley (chairman of the subcommittee) presiding.

Present: Senator Grassley.

OPENING STATEMENT OF SENATOR GRASSLEY

Senator GRASSLEY. If I could, I would request that everybody give attention to the calling to order of this hearing, a hearing conducted by the Subcommittee on Aging of the Senate Committee on Labor and Human Resources.

I welcome everybody to this hearing, which deals with the issue of pension accrual and how it affects the older worker.

Today, we are to examine the issues involved in the Equal Employment Opportunity Commission's decision to rescind the Department of Labor's interpretive ruling on section 4(f)(2) of the Age Discrimination in Employment Act. Based on that ruling, employers are permitted to halt the accrual of pension benefits when an employee reaches "normal" retirement age, usually 65. The EEOC, which took over the administration and enforcement of ADEA in 1978, voted in June 1984 to rescind the Department of Labor's interpretive ruling and to promulgate regulations to require benefit accruals for persons who work past age 65. The EEOC's decision is currently under review within the administration.

Today's hearing will also consider H.R. 2712, which was introduced by Representatives Biaggi, Rinaldo, and Pepper, and S. 1427, which I introduced. Both bills would also require accruals past age 65.

The purpose of today's hearing is to examine current policy and the proposed changes from the perspectives of older workers and of course, the business community, their employers.

Some specific issues we will address are: (1) How private pension plans currently treat older workers; (2) the cost to older workers of not requiring post-65 pension accrual; (3) the potential cost to employers and pension plans of requiring post-65 pension accrual; (4) the impact of current policy on employees' decisions whether or not to work past age 65; and lastly, (5) the potential impact of requiring post-65 accrual of corporate decisions to hire or retain older workers.

We are privileged to have a group of witnesses who are well-qualified to discuss post-65 pension accrual.

The subcommittee will receive testimony from: Clarence Thomas, Chairman of the EEOC; Joseph Silvestri, general attorney of the J.C. Penney Co., on behalf of the ERISA Industry Committee; Herbert Liebenson, president of the National Small Business Association; Norman S. Losk, chairman of the Pension Committee of the American Academy of Actuaries; Robert W. Kalman, associate, with William M. Mercer-Meidinger, Inc.; Emily Andrews, research director for the Employee Benefit Research Institute, and Jack Guildroy, member of the National Legislative Council, American Association of Retired Persons.

We are not able to have Representatives Rinaldo and Biaggi with us today. At least one of those people will be submitting testimony in writing.

[The prepared statement of Representative Rinaldo follows:]

TESTIMONY

BEFORE THE SUBCOMMITTEE ON AGING
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
October 17, 1985

THE HONORABLE MATTHEW J. RINALDO
a Representative from the State of New Jersey

Mr. Chairman, I applaud your leadership in calling this hearing and am pleased to submit comments on the issue of pension accrual and the older worker.

As Ranking Republican Member of the House Select Committee on Aging, one of my top priorities has always been to expand job opportunities for older workers. I have introduced or cosponsored legislation to remove the outside earnings limitation for Social Security recipients, amend the Targeted Jobs Tax Credit to include disadvantaged older workers, expand the Title V senior community service employment program under the Older Americans Act, and continue the Senior Environmental Employment Program at the Environmental Protection Agency.

With my colleagues Mario Biaggi, the Chairman of the Aging Committee's Human Services Subcommittee, and Claude Pepper, the Chairman of the Aging Committee's Subcommittee on Health and Long term Care, I have introduced H.R. 2712, the Older Workers Employment Protection Act. This measure would assist older workers by first, requiring employers to continue pension accruals as long as the individual continues to work and second, by lifting the age 70 cap from the protections offered by the Age Discrimination in Employment Act (ADEA), thus prohibiting mandatory retirement at any age.

The pension provision of this legislation, similar to S. 1427, which you have introduced, is necessary because of a controversial Department of Labor interpretation of the ADEA. This interpretation, issued by the Department in 1978 and since then adhered to by the Equal Employment Opportunity Commission (EEOC), allows employers to freeze an individual's pension credits once the individual has reached the normal retirement age specified in the plan, usually age 65. Thus, while a worker is currently protected under the ADEA in hiring, firing, and other terms or conditions of employment until he reaches age 70, his pension benefit may stop growing well before he reaches that age.

While I am pleased that the EEOC voted in June 1984 to rescind this interpretive provision and replace it with substantive rules which would require employers covered by the ADEA to provide pension credits and contributions for employees who work beyond normal retirement age, the timetable of this regulatory process is unclear and the eventual outcome is uncertain. Passage of our legislation, on the other hand, would require rapid implementation of regulations to mandate pension accruel.

Mr. Chairman, this legislation is necessary for several reasons.

First, the provision allowing employers to cease pension accruals before an individual ceases work clearly frustrates the goals and objectives of the ADEA. The statute states that the purpose of the ADEA is to "promote the employment of older persons based on their ability rather than age" (Sec. 2(b)) and "to prohibit arbitrary age discrimination in employment" (Sec. 4(a)). The current provision permits the cessation of pension contributions at an arbitary age (the normal retirement age) without any justification, financial or otherwise. Many older individuals may be discouraged from continued work once their pensions are frozen.

Second, the provision cannot be justified by the section in the statute (Sec. 4(f)(2)) which allows employers to vary benefits based on age where a decrease in benefits may be justified by age-related cost increases. To contend that this provision sanctions a freeze in pension accruals would allow employers to deny benefits to employees working beyond the normal retirement age based not on cost, but exclusively on age.

The fact is that cost provides no justification for freezing pension accruals. A detailed report done at the Aging Committee's request by actuary Anna Rappaport (An Analysis of the Costs of Pension Accrual After Age 65, 1982) buried the notion that pension contributions are significantly more expensive to provide for older rather than younger workers. In fact, according to the respected Employee Benefit Research Institute (EBRI), more than half of defined benefit pension plan participants in medium and large firms are already covered by plans that offer at least some adjustment for service after the plan's normal retirement age.

Finally, while corporate costs of mandating pension accrual may be low, the absence of accrual can be extemely detrimental to older employees. An employee delaying retirement for two years can lose anywhere from 4 percent to 23 percent of the value of lifetime accrued benefits, EBRI reports. An employee delaying retirement for five years can lose up to half the value of pension benefit accrual at age 65.

Mr. Chairman, mandating pension accrual until an individual ceases working—at whatever age—is consistent with the purpose of the Age Discrimination in Employment Act. It is a significant economic benefit to those individuals who continue to work. And it is not a prohibitive expense to employers. I am delighted that you have taken the initiative in this body and am hopeful that, together, we will be able to pass legislation in the 99th Congress.

Senator **Grassley**. We will now go to our first witness, Chairman Thomas, Chairman of the EEOC. Welcome to the subcommittee, and we look forward to your testimony. Also, thank you for being patient while I was tardy.

Before you start out, I hope my staff has asked everybody to summarize their statements in hopefully 5 to 7 minutes. That way, we will have time for questions. Is that all right with you? You are probably used to that, anyway.

Mr. **Thomas**. Yes.

Senator **Grassley**. All right. And then your whole statement will be placed in the record, unless you ask otherwise.

Please proceed.

STATEMENT OF CLARENCE THOMAS, CHAIRMAN, EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

Mr. **Thomas**. Good morning, Chairman Grassley.

We have submitted a complete statement for the record, and I have a very brief summary of some points that I would like to make.

I appreciate the opportunity to appear before you to report on the Equal Employment Opportunity Commission's decision to revise the agency's interpretive provisions pertaining to pension and retirement plans to comport with the purposes and requirements of the Age Discrimination in Employment Act.

On June 26, 1984, the Equal Employment Opportunity Commission voted to rescind those interpretive provisions and replace them with substantive rules which will require employers covered by the ADEA to provide pension credits and contributions for employees who work beyond normal retirement age. The proposed rules were adopted on March 5, 1985, for coordination with affected agencies under Executive Order 12067. The proposed regulations have been circulated to the affected agencies, the Department of Treasury, the Pension Benefit Guaranty Corporation, the Department of Labor, and the Social Security Administration.

These affected Federal agencies are entitled to review and comment on the proposed regulations. To date, we have received staff comments from all of these agencies and are awaiting their final comments

Executive Order 12067 provides for a mechanism whereby disputes among the issuing and commenting agencies can be resolved.

It is our hope, however, that we will be able to resolve any disagreements without resort to the formal mechanisms for dispute resolution under Executive Order 12067.

Several estimates have been made of the annual cost of the Commission's proposals. These estimates range upward from a low estimate of $280 million. Under Executive Order 12291, any proposed rule which is estimated to have an annual effect on the economy of $100 million or more is designated a major rule and requires a regulatory impact analysis. Consistent with the Executive order, the Commission is now preparing such an impact analysis. We are presently engaged in the process of contracting with technical experts to provide assistance in the preparation of this analysis.

The analysis will examine the overall benefits and costs of the Commission proposal, and the benefits and costs of alternative approaches. The analysis has been projected for completion in the first half of 1986.

After reconciliation of the comments from affected agencies and completion of the regulatory impact analysis, but prior to publication in the Federal Register for public notice and comment, the proposed regulations must be coordinated with the Office of Management and Budget.

The Commission believes that the action it is proposing will accord to our nation's older workers the protections which the ADEA was intended to provide. Contributions and crediting for postnormal retirement age employment will provide a valuable incentive for all employees desirous of exercising their legal right to work and may also provide hope for those employees whose pensions are currently inadequate to support retirement.

The subcommittee has also asked for the Commission's comments on S. 1427 and H.R. 2712. The Commission as a body has not taken a formal position on either of these legislative measures.

I would like to also reiterate that the comments and the regulations adopted by the Commission have not been coordinated with OMB or other members of the executive branch.

I would be happy to respond to any questions you might have.

[The prepared statement of Mr. Thomas follows:]

STATEMENT OF CLARENCE THOMAS, CHAIRMAN
U.S. EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
BEFORE THE UNITED STATES SENATE SUBCOMMITTEE ON AGING
OCTOBER 17, 1985

GOOD MORNING, SENATOR GRASSLEY, AND MEMBERS OF THE SUBCOMMITTEE. I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TO REPORT ON THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION'S DECISION TO REVISE THE AGENCY'S INTERPRETATIVE PROVISIONS PERTAINING TO PENSION AND RETIREMENT PLANS TO COMPORT WITH THE PURPOSES AND REQUIREMENTS OF THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967 (ADEA), AS AMENDED.

THE REORGANIZATION PLAN NO. 1 OF 1978 TRANSFERRED AUTHORITY FOR THE ADMINISTRATION AND ENFORCEMENT OF THE ADEA FROM THE DEPARTMENT OF LABOR TO THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION. FIVE WEEKS PRIOR TO THE TRANSFER OF THAT AUTHORITY, THE DEPARTMENT OF LABOR HAD ISSUED INTERPRETATIVE PROVISIONS EXPLAINING SECTION 4(F)(2) OF THE ADEA, WHICH PERMITTED PENSION AND RETIRMENT PLANS TO DISCONTINUE CONTRIBUTIONS AND CREDITING FOR EMPLOYEES WHO WORKED BEYOND NORMAL RETIRMENT AGE.

ON JUNE 26, 1984, THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION VOTED TO RESCIND THOSE INTERPRETATIVE PROVISIONS AND REPLACE THEM WITH SUBSTANTIVE RULES WHICH WILL REQUIRE EMPLOYERS COVERED BY THE ADEA TO PROVIDE PENSION CREDITS AND CONTRIBUTIONS FOR EMPLOYEES WHO WORK BEYOND NORMAL RETIREMENT AGE.

AFTER THE COMMISSION'S APPROVAL, UNDER EXECUTIVE ORDER 12067, THE RULES WERE FORWARDED TO OTHER AFFECTED AGENCIES FOR REVIEW AND COMMENT.

THE COMMISSION'S VOTE WAS THE CULMINATION OF MORE THAN FOUR YEARS OF EXHAUSTIVE STUDY AND REVIEW OF THE FORMER INTERPRETATIVE PROVISIONS. THAT REVIEW FOCUSED ON BOTH THE LEGAL BASIS AND THE PRACTICAL EFFECT OF THE PROVISIONS ON THE WORKING ELDERLY. THE COMMISSION BELIEVES THAT THE RECISSION AND REPLACEMENT OF THE PROVISIONS WILL ASSIST IN ASSURING THAT THE WORKING ELDERLY ARE ENTITLED TO ALL THE PROTECTIONS OF THE ADEA.

THERE ARE SEVERAL FACTORS WHICH PRECIPITATED THE COMMISSION'S ACTION.

FIRST, THE COMMISSION BELIEVES THAT THE PROVISIONS DID NOT PROMOTE THE STATED PURPOSES OF THE ADEA. THE PURPOSE OF THE ADEA IS "TO PROMOTE THE EMPLOYMENT OF OLDER PERSONS BASED ON THEIR ABILITY RATHER THAN AGE" AND "TO PROHIBIT ARBITRARY AGE DISCRIMINATION IN EMPLOYMENT ...". WE BELIEVE THAT THE INTERPRETATIVE PROVISIONS CONFLICTED WITH THESE PURPOSES IN TWO IMPORTANT RESPECTS. (1) THE RULES ISSUED BY THE DEPARTMENT OF LABOR PERMITTED THE CESSATION OF CONTRIBUTIONS AND CREDITING AT AN ARBITRARY AGE, THE NORMAL RETIREMENT AGE, WITHOUT FINANCIAL OR OTHER JUSTIFICATION. IN DOING SO, THE RULES EFFECTIVELY PERMITTED AN EMPLOYER TO "FREEZE"

EMPLOYEE PENSIONS AT THE NORMAL RETIREMENT AGE. (2) NOT ONLY WOULD AN EMPLOYEE NOT EARN FURTHER CREDITS FOR CONTINUED EMPLOYMENT, BUT THE ACTUARIAL PRESENT VALUE OF THE EMPLOYEE'S PENSION WOULD SUBSTANTIALLY DECLINE. THESE FACTORS TENDED TO DISCOURAGE THE CONTINUED EMPLOYMENT OF EMPLOYEES OF POST-NORMAL RETIREMENT AGE.

THE COMMISSION BELIEVES THAT THE PROPOSED RULES REGARDING POST-NORMAL RETIREMENT AGE PENSION CONTRIBUTIONS COMPORT WITH THE LEGISLATIVE HISTORY AND PURPOSE BEHIND SECTION 4(F)(2) OF THE ADEA.

THE SECOND FACTOR WHICH PRECIPITATED THE COMMISSION'S PROPOSED RULE CHANGE WAS THAT CONGRESS RECOGNIZED, IN PASSING THE ADEA IN 1967, THAT THE COST OF PROVIDING CERTAIN BENEFITS TO OLDER WORKERS IS GREATER THAN THE COST OF PROVIDING CERTAIN BENEFITS TO YOUNGER WORKERS. REQUIRING THAT EQUAL BENEFITS BE PROVIDED TO EMPLOYEES REGARDLESS OF AGE WOULD HAVE DISCOURAGED THE EMPLOYMENT OF OLDER WORKERS. TO AVOID THAT RESULT, THEN SENATOR JACOB JAVITS INTRODUCED THE AMENDMENT WHICH BECAME SECTION 4(F)(2) OF THE ADEA. THAT SECTION PERMITS AN EMPLOYER TO "OBSERVE THE TERMS OF A BONA FIDE EMPLOYEE BENEFIT PLAN SUCH AS A RETIREMENT, PENSION, OR INSURANCE PLAN, WHICH IS NOT A SUBTERFUGE TO EVADE THE PURPOSES OF THE ACT." IN EXPLAINING THE PURPOSE BEHIND THE AMENDMENT, CONGRESS STATED, IN 1967, THAT SECTION 4(F)(2) WAS INTENDED TO ALLOW EMPLOYERS TO LEGITIMATELY VARY BENEFITS BASED ON AGE WHERE A DECREASE IN BENEFITS COULD BE JUSTIFIED BY AGE RELATED COST INCREASES.

THUS, THE INTENT OF THE SECTION 4(F)(2) EXCEPTION WAS TO PROVIDE BENEFITS TO OLDER WORKERS TO THE EXTENT THAT THE BENEFITS ARE NO MORE EXPENSIVE THAN BENEFITS PROVIDED TO YOUNGER WORKERS.

INCURRING EQUAL COST FOR BENEFITS WOULD ENSURE THAT OLDER EMPLOYEES ARE, IN FACT, PROVIDED BENEFITS LIKE THEIR YOUNGER COUNTERPARTS, AND THAT EMPLOYERS ARE NOT DISCOURAGED FROM HIRING OR RETAINING OLDER WORKERS DUE TO EXCESSIVE BENEFIT COSTS AT LATER AGES. THE COMMISSION BELIEVES THAT THE FORMER INTERPRETATION MAY HAVE GONE FURTHER THAN NECESSARY TO ACCOMPLISH THESE DUAL OBJECTIVES, IN THAT THE INTERPRETATION PERMITTED EMPLOYERS TO DENY BENEFITS TO EMPLOYEES WORKING BEYOND THE NORMAL RETIREMENT AGE, BASED NOT ON COST, BUT BASED EXCLUSIVELY ON THEIR AGE.

THIRD, THE DEPARTMENT OF LABOR'S 1979 INTERPRETATION, WHICH PERMITTED THE CESSATION OF PENSION CONTRIBUTIONS AND CREDITING, WAS, IN OUR VIEW, FACIALLY INCONSISTENT WITH THE DEPARTMENT'S OWN LONG-STANDING ADMINISTRATIVE INTERPRETATION OF THE REQUIREMENTS OF SECTION 4(F) (2). SHORTLY AFTER THE PASSAGE OF THE ADEA IN 1967, THE DEPARTMENT OF LABOR ISSUED AN INTERPRETATION OF SECTION 4(F) (2) IN 1969 WHICH STATED THAT:

> A RETIREMENT, PENSION, OR INSURANCE PLAN WILL BE CONSIDERED IN COMPLIANCE WITH THE STATUTE WHERE THE ACTUAL AMOUNT OF PAYMENT MADE, OR COST INCURRED, IN BEHALF OF AN OLDER WORKER IS EQUAL TO THAT MADE OR INCURRED IN BEHALF OF A YOUNGER WORKER, EVEN

> THOUGH THE OLDER WORKER MAY THEREBY RECEIVE A LESSER AMOUNT OF PENSION OR RETIREMENT BENEFITS, OR INSURANCE COVERAGE.

THAT 1969 INTERPRETATION EMBODIED THE "EQUAL BENEFIT OR EQUAL COST" PRINCIPLE AND WAS THE OPERATIVE ADMINISTRATIVE INTERPRETATION OF SECTION 4(F)(2) FOR MORE THAN TEN YEARS. THE INTERPRETATION GAVE EFFECT TO THE COST CONSIDERATIONS WHICH PRECIPITATED THE EXCEPTION IN THE FIRST INSTANCE WHILE IT, NEVERTHELESS, GUARANTEED THAT OLDER EMPLOYEES WOULD ACTIVELY PARTICIPATE IN BENEFIT PROGRAMS IN A MANNER WHICH WOULD REQUIRE COST EQUIVALENCE BY THE EMPLOYER.

THE COMMISSION FIRMLY BELIEVES THAT THE PRINCIPLES IN THAT ORIGINAL INTERPRETATION MOST EFFECTIVELY HARMONIZED THE PURPOSES OF THE STATUTE AND THE LIMITED PURPOSES OF THE EXCEPTION CONTAINED IN SECTION 4(F) (2). THEREFORE, WE BELIEVE THAT THE 1979 DEPARTMENT OF LABOR INTERPRETATION CONSTITUTED A SUBSTANTIAL DEPARTURE FROM THE PRINCIPLE FIRST ENUNCIATED IN THE ORIGINAL INTERPRETATION, AND MAY HAVE UNNECESSARILY PENALIZED THE OLDER WORKERS THE STATUTE IS DESIGNED TO PROTECT IN AN EFFORT TO ENSURE THAT EMPLOYERS NOT BE FORCED TO INCUR EXCESSIVE COSTS ON BEHALF OF OLDER WORKERS.

FOURTH, THE COMMISSION HAD SERIOUS MISGIVINGS ABOUT THE LEGAL EFFECT OF THOSE PORTIONS OF THE 1978 LEGISLATIVE HISTORY OF THE ADEA UPON WHICH THE DEPARTMENT OF LABOR RELIED TO PROMULGATE ITS PENISION RULES. AS YOU KNOW, CONGRESS AMENDED THE ADEA IN 1978 IN SEVERAL RESPECTS. SECTION 4(F)(2) WAS AMENDED TO CLARIFY THAT THE SECTION DID NOT PERMIT THE INVOLUNTARY RETIREMENT OF EMPLOYEES. AT THE SAME TIME, CONGRESS EXTENDED THE UPPER AGE COVERAGE OF THE ADEA FROM 65 TO 70. IN CONTEMPLATION OF THIS SECOND AMENDMENT, SENATORS WILLIAMS AND JAVITS REQUESTED AN OPINION FROM THE DEPARTMENT OF LABOR REGARDING ANY POTENTIAL CONFLICTS WITH THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, (ERISA). THEN ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS, DONALD ELISBURG, RESPONDED BY DECLARING THAT EMPLOYERS WOULD NOT HAVE TO PROVIDE PENSION CONTRIBUTIONS AND CREDITING FOR EMPLOYEES WHO WORKED BEYOND THE NORMAL RETIREMENT AGE. ASSISTANT SECRETARY ELISBURG'S LETTER WAS MADE A PROMINENT PART OF THE 1978 LEGISLATIVE HISTORY AND THEN WAS RELIED UPON BY THE DEPARTMENT OF LABOR FOR ITS NEW INTERPRETIVE PROVISIONS ONE YEAR LATER.

FROM A LEGAL PERSPECTIVE, THE COMMISSION HAD SEVERAL CONCERNS OVER THE WEIGHT ACCORDED TO THE ELISBURG LETTER. UNDENIABLY, THE LETTER CONCLUDED THAT EMPLOYERS MAY CEASE

PENSION CONTRIBUTIONS AND CREDITING AT THE NORMAL RETIREMENT AGE; AND THAT EMPLOYERS MAY ALSO FAIL TO ADJUST ACTUARIALLY PENSION BENEFITS TO REFLECT A POSTPONED RETIREMENT DATE. IN THE COMMISSION'S VIEW, THE ELISBURG LETTER, ON BEHALF OF THE DEPARTMENT OF LABOR, APPEARS INCONSISTENT WITH THE EXISTING LABOR DEPARTMENT INTERPRETATION PUBLISHED WITH THE PASSAGE OF THE ADEA ALMOST TEN YEARS EARLIER. ABSENT FROM THAT ORIGINAL INTERPRETATION WAS ANY "SPECIAL RULE" ALLOWING EMPLOYERS TO DISCONTINUE PENSION CONTRIBUTIONS AND CREDITING AT THE NORMAL RETIREMENT AGE. CONGRESS THEN APPARENTLY RELIED ON THIS POSITION WHEN AMENDING THE STATUTE. THUS, THE "LEGISLATIVE HISTORY" APPEARS TO BE A PRODUCT OF THE ELISBURG LETTER IN THE FIRST INSTANCE.

EQUALLY IMPORTANT, THE COMMISSION HAD SUBSTANTIAL RESERVATIONS CONCERNING THE RELEVANCE OF THE ELISBURG LETTER. THE ELISBURG LETTER, IN FACT, ATTEMPTED TO CHARACTERIZE THE REQUIREMENTS OF SECTION 4(F)(2) OF THE ADEA. THAT SECTION WAS UNAMENDED IN 1978, EXCEPT WITH RESPECT TO THE INCLUSION OF THE PROHIBITION CONCERNING MANDATORY RETIREMENT. UNDER LONGSTANDING PRINCIPLES OF STATUTORY CONSTRUCTION WHICH HAVE TWICE BEEN APPLIED TO THE 1978 AMENDMENTS TO THE ADEA, "LEGISLATIVE OBSERVATIONS 10 YEARS AFTER THE PASSAGE OF THE ACT ARE IN NO SENSE PART OF THE LEGISLATIVE HISTORY."

ABSENT AMENDMENT, "IT IS THE INTENT OF THE CONGRESS THAT ENACTED THE SECTION THAT CONTROLS." FOR THOSE REASONS, THE SUPREME COURT HAS TWICE REJECTED 1978 LEGISLATIVE OBSERVATIONS CONCERNING AN UNAMENDED PROVISION OF THE ADEA, FIRST IN UNITED AIRLINES LINES v. McMANN AND LATER IN OSCAR MAYER & CO. v. EVANS. IN THE OSCAR MAYER CASE, THE COURT EXPLICITLY REJECTED THE SAME SENATE CONFERENCE REPORT IN WHICH THE ELISBURG LETTER WAS REPRINTED. WE BELIEVE THAT THE HOLDINGS OF THESE CASES ARE CLEARLY APPLICABLE HERE; AND, THAT ABSENT SUBSTANTIVE AMENDMENT TO SECTION 4(F)(2), THE ELISBURG LETTER, AND THE COMMENTS IT PRECIPITATED, DO NOT AMOUNT TO CONTROLLING LEGISLATIVE HISTORY. IT IS THE INTENT OF THE 1967 CONGRESS THAT CONTROLS.

FINALLY, THE COMMISSION RELIED ON FINANCIAL INFORMATION FROM TWO SOURCES TO BUTTRESS ITS DECISION TO RESCIND THE FORMER RULES. FIRST, THE INFORMATION PAPER, PREPARED BY NOTED ACTUARY ANNA RAPPAPORT AND ENTITLED AN ANALYSIS OF THE COSTS OF PENSION ACCRUAL AFTER AGE 65, LAID TO REST THE MISTAKEN NOTION THAT PENSION CONTRIBUTIONS FOR OLDER WORKERS ARE MORE EXPENSIVE TO PROVIDE THAN FOR YOUNGER WORKERS. MS. RAPPAPORT'S CONCLUSIONS ELIMINATED COST CONSIDERATIONS AS A JUSTIFIABLE BASIS FOR THE CESSATION OF PENSION CONTRIBUTIONS AND CREDITING AT THE NORMAL

RETIREMENT AGE. ABSENT BONA FIDE INCREASES IN COST, THE COMMISSION WAS HARDPRESSED TO FIT THE INTERPRETATIVE PROVISIONS WITHIN THAT NARROW RANGE OF CONDUCT PERMITTED BY THE SECTION 4(F)(2) EXCEPTION.

MOREOVER, TO THE EXTENT THAT THE CURRENT PRACTICE OF CEASING CONTRIBUTIONS PROVIDES A "WINDFALL" TO EMPLOYERS, DETAILED COMMENTS PROVIDED TO THE COMMISSION BY THE AMERICAN ACADEMY OF ACTUARIES INDICATED THAT, EVEN WITH CONTINUED CONTRIBUTIONS, EMPLOYERS WILL BENEFIT FROM A 2-4% DECREASE IN THE ACTUARIAL PRESENT VALUE OF THE PENSIONS FOR THOSE EMPLOYEES WORKING BEYOND THE NORMAL RETIREMENT AGE.

THREE PRINCIPAL OBJECTIONS HAVE HISTORICALLY BEEN INTERPOSED TO ANY PROPOSED CHANGES IN THE FORMER INTERPRETATIVE PROVISIONS. THOSE OBJECTIONS WERE THE COST OF THE CHANGE TO EMPLOYERS, THE 1978 LEGISLATIVE HISTORY SUPPORTING THE FORMER RULES, AND THE ARGUMENT THAT ANY POTENTIAL CHANGES WOULD CONFLICT WITH ERISA. THE TWO FIRST ARGUMENTS ASIDE, THE COMMISSION CONCLUDED THAT ITS PROPOSED RULES WOULD PRESENT NO CONFLICTS WITH ERISA.

SECTION 202(A)(2) OF ERISA PERMITS AN EMPLOYER TO EXCLUDE FROM A DEFINED BENEFIT PLAN OR TARGET PLAN AN EMPLOYEE HIRED WITHIN FIVE YEARS OF THE NORMAL RETIREMENT AGE. SUBSEQUENT ADMINISTRATIVE REGULATIONS PROMULATED BY THE DEPARTMENT OF LABOR HAVE INTERPRETED THAT, AND OTHER ERISA PROVISIONS, TO ALLOW AN EMPLOYER TO DISCONTINUE PENSION CONTRIBUTIONS AND CREDITING AT THE NORMAL RETIREMENT AGE SPECIFIED IN THE PLAN. INTERNAL REVENUE SERVICE INTERPRETATIONS OF THE COMPANION PROVISIONS IN THE TAX CODE ARE SIMILARLY PERMISSIVE IN NATURE. NEITHER REQUIRE CONTRIBUTIONS AND CREDITING FOR POST-NORMAL RETIREMENT AGE EMPLOYMENT.

FURTHER, WE BELIEVE THAT AN ADMINISTRATIVE RULE PROMULGATED BY THE EEOC IMPLEMENTING THE ADEA BY REQUIRING PENSION CONTRIBUTIONS AND CREDITING WOULD NOT CREATE A "CONFLICT" WITH ERISA OR THE INTERNAL REVENUE CODE. IN A LEGAL SENSE, A "CONFLICT" OF LAWS OCCURS WHEN THE OPERATION OF TWO LAWS CREATES A POSITIVE REPUGNANCY BETWEEN THE TWO, RENDERING ONE OR BOTH UNENFORCEABLE. THAT IS NOT THE CASE HERE BECAUSE AN ADEA RULE WHICH REQUIRES CONTINUED CREDITING AND CONTRIBUTIONS WOULD NOT AFFECT ANY EMPLOYER'S TAX STATUS UNDER THE INTERNAL REVENUE CODE, NOR WOULD IT AFFECT AN EMPLOYER'S STATE OF COMPLIANCE UNDER ERISA. MOREOVER, IN SHAW v. DELTA AIR LINES, 103 S. CT. 1890 (1983), THE SUPREME COURT RECENTLY RECOGNIZED THAT FEDERAL EMPLOYMENT DISCRIMINATION LAWS MAY REQUIRE EMPLOYERS TO PROVIDE WELFARE AND PENSION BENEFITS WHICH ARE NOT REQUIRED BY ERISA. THAT WILL BE THE EFFECT OF THE COMMISSION'S PROPOSED RULES.

AND, OF COURSE, NOTWITHSTANDING THE FOREGOING, THE COMMISSION RELIES ON INDUSTRY PRACTICE TO SUBSTANTIATE ITS CONCLUSION THAT NO INHERENT INCOMPATIBILITY EXISTS BETWEEN THE PRINCIPLES OF ERISA AND THE CONCEPT OF POST-NORMAL RETIREMENT AGE PENSION CONTRIBUTIONS. BOTH MS. RAPPAPORT AND THE DEPARTMENT OF LABOR HAVE PUBLISHED ARTICLES IN WHICH IT WAS REVEALED THAT UPWARDS OF 50% OF ALL PENSION PLANS CURRENTLY PROVIDE FOR SOME TYPE OF CONTINUED CONTRIBUTIONS AND CREDITING FOR WORK BEYOND THE NORMAL RETIREMENT AGE. SEE, RAPPAPORT, A. AND COPPERMAN, L., PENSION AND WELFARE BENEFITS FOR OLDER WORKERS: THE PRELIMINARY IMPACT OF THE ADEA AMENDMENTS, AGING AND WORK, SPRING 1980: EMPLOYEE BENEFITS ON MEDIUM AND LARGE FIRMS, 1983, U.S. DEPARTMENT OF LABOR, BUREAU OF LABOR STATISTICS, BULLETIN 2213, AUGUST 1984. CLEARLY, EMPLOYERS WOULD NOT GRATUITOUSLY PROVIDE THOSE BENEFITS IF DOING SO JEOPARDIZED THEIR ERISA COMPLIANCE IN ANY WAY.

THE COMMISSION VOTED TO RESCIND THE EXISTING INTERPRETATIONS AND HAS PROPOSED RULES WHICH WILL REQUIRE EMPLOYERS TO CONTINUE CONTRIBUTIONS AND CREDITING FOR EMPLOYEES WORKING BEYOND THE NORMAL RETIREMENT AGE.

TO SUMMARIZE, THE COMMISSION'S PROPOSED RULES WERE PREMISED ON THE COMMISSION'S BELIEFS THAT:

(1) THE FORMER INTERPRETIVE PROVISIONS WERE NOT CONSISTENT WITH THE STATED PURPOSES OF THE ADEA;

(2) NEW RULES REGARDING POST-NORMAL RETIREMENT AGE PENSION CONTRIBUTIONS, WHICH COMPORT WITH THE LEGISLATIVE HISTORY AND PURPOSE BEHIND SECTION 4(F)(2) OF THE ADEA, ARE DESIRABLE;

(3) THE DEPARTMENT OF LABOR'S 1979 INTERPRETATION, WHICH PERMITTED THE CESSATION OF PENSION CONTRIBUTIONS, APPEARED INCONSISTENT WITH THE DEPARTMENT OF LABOR'S EARLIER ADMINISTRATIVE INTERPRETATION OF SECTION 4(F)(2); AND

(4) THE DEPARTMENT OF LABOR'S RELIANCE ON PORTIONS OF THE 1978 LEGISLATIVE HISTORY OF THE ADEA IN PROMULGATING ITS 1979 RULES, APPEARED MISPLACED.

THE COMMISSION BELIEVES THAT THE ACTION IT IS PROPOSING WILL ACCORD TO OUR NATION'S OLDER WORKERS THE PROTECTIONS WHICH THE ADEA WAS INTENDED TO PROVIDE. CONTRIBUTIONS

AND CREDITING FOR POST-NORMAL RETIRMENT AGE EMPLOYMENT WILL PROVIDE A VALUABLE INCENTIVE FOR ALL EMPLOYEES DESIROUS OF EXERCISING THEIR LEGAL RIGHT TO WORK AND MAY ALSO PROVIDE HOPE FOR THOSE EMPLOYEES WHOSE PENSIONS ARE CURRENTLY INADEQUATE TO SUPPORT RETIREMENT.

THE COMMISSION ALSO BELIEVES THAT THE PROPOSED RULES REGARDING POST NORMAL RETIREMENT AGE PENSION CONTRIBUTIONS COMPORT WITH THE LEGISLATIVE HISTORY AND PURPOSE BEHIND SECTION 4(F)(2) OF THE ADEA.

THE PROPOSED REGULATIONS HAVE BEEN CIRCULATED TO THE DEPARTMENT OF THE TREASURY, THE PENSION BENEFIT GUARANTY CORPORATION, THE DEPARTMENT OF LABOR AND THE SOCIAL SECURITY ADMINISTRATION, PURSUANT TO EXECUTIVE ORDER 12067. THESE AFFECTED AGENCIES ARE ENTITLED TO REVIEW AND COMMENT UPON THE PROPOSED REGULATIONS. TO DATE, WE HAVE RECEIVED STAFF COMMENTS FROM ALL OF THESE AGENCIES AND ARE AWAITING THEIR FINAL COMMENTS.

EXECUTIVE ORDER 12067 PROVIDES A MECHANISM WHEREBY DISPUTES AMONG THE ISSUING AND COMMENTING AGENCIES CAN BE RESOLVED. WE TRUST, HOWEVER, THAT WE WILL BE ABLE TO RESOLVE ANY DISAGREEMENTS WITHOUT RESORTING TO THE FORMAL MECHANISMS FOR DISPUTE RESOLUTION UNDER EXECUTIVE ORDER 12067.

AFTER RECONCILIATION OF THE COMMENTS FROM AFFECTED AGENCIES AND COMPLETION OF A "REGULATORY IMPACT ANALYSIS,"1/ PRIOR TO PUBLICATION IN THE FEDERAL REGISTER FOR PUBLIC NOTICE AND COMMENT, THE PROPOSED REGULATION MUST BE SUBMITTED TO THE OFFICE OF MANAGEMENT AND BUDGET UNDER EXECUTIVE ORDER 12291.

THE SUBCOMMITTEE HAS ALSO ASKED FOR THE COMMISSION'S COMMENTS ON S.1427 AND H.R.2712.

THE COMMISSION, AS A BODY, HAS NOT TAKEN A POSITION REGARDING EITHER S.1417 OR H.R.2712.

I WOULD BE HAPPY, AT THIS TIME, TO RESPOND TO ANY QUESTIONS THAT YOU MAY HAVE.

1/ UNDER EXECUTIVE ORDER 12291, ANY PROPOSED RULE WHICH IS ESTIMATED TO HAVE AN ANNUAL EFFECT ON THE ECONOMY OF $100 MILLION OR MORE IS DESIGNATED A "MAJOR RULE" AND REQUIRES A "REGULATORY IMPACT ANALYSIS." THE COMMISSION IS PREPARING SUCH AN ANALYSIS. WE ARE PRESENTLY ENGAGED IN THE PROCESS OF CONTRACTING WITH TECHNICAL EXPERTS TO PROVIDE ASSISTANCE IN THE PREPARATION OF THE ANALYSIS. THE ANALYSIS WILL EXAMINE THE OVERALL BENEFITS AND COSTS OF THE COMMISSION'S PROPOSAL AND THE BENEFITS AND COSTS OF ALTERNATIVE APPROACHES. THE ANALYSIS IS PROJECTED FOR COMPLETION IN THE FIRST HALF OF 1986.

Senator GRASSLEY. In regard to your last comment about OMB, is your agency under the same mandate to have approval of testimony by OMB that the Cabinet-level agencies are?

Mr. THOMAS. That is right, Senator, and under the same Reorganization Plan No. 1, in 1978, pursuant to which the Equal Employment Opportunity Commission acquired jurisdiction over the ADEA. EEOC also became clearly a member of the executive branch, so we are the only independent regulatory agency that is a part of the executive branch and as such we are subject to all of the rules that would pertain to the Cabinet-level departments.

Senator GRASSLEY. But there is not any particular prejudice implied by the fact that OMB has not approved your statement?

Mr. THOMAS. There is no prejudice from our standpoint.

Senator GRASSLEY. How about from theirs? I was thinking more from their standpoint.

Mr. THOMAS. Well, let us just say that with respect to the position we are taking, I think it is fair to characterize it as "swimming upstream".

Senator GRASSLEY. OK. I am glad you made that clear for the record.

In your statement, you have outlined the steps that need to be taken before you publish your proposed rules in the Federal Register. To date, you have received staff comments from those agencies that are affected by your proposed rules. Do you have any indication of when final comments from those agencies will be forthcoming?

Mr. THOMAS. We do not at this point, but it is a matter of really putting a deadline on them.

Senator GRASSLEY. Is that something you can do?

Mr. THOMAS. We can, since we have the lead responsibility here.

Senator GRASSLEY. And I assume you will—right?

Mr. THOMAS. In order to expedite the process, we have to, but again, we are still waiting on the—we have to coordinate this and probably make it consistent with when we expect to get the impact analysis completed. So we are looking probably at some point in the spring.

Senator GRASSLEY. Do you have to wait for that impact analysis, then, before the other agencies can make final comment?

Mr. THOMAS. No; we do not have to wait, but since we have to before publishing them in the Federal Register, we need the impact anaylsis. So it is a matter of just simply coordinating it, too.

I might add that the requirement of an impact analysis was a subject of discussion after we voted on the regulations, and it was concluded at that point that the impact analysis was indeed necessary.

Senator GRASSLEY. Now, in regard to the fact that you believe that you have no reason to anticipate any problems in resolving issues of dispute raised by the commenting agencies, is that assessment based on the staff comments you have received? In other words, can the subcommittee assume that no issues have been raised at the staff level that might be considered insurmountable?

Mr. THOMAS. I think we, at the head of these agencies, have to have a great supply of hope and optimism, but there are very significant issues that have been raised that are diametrically opposed to the position the Commission has taken on its interpretation of ADEA. In addition, there are comments that go beyond the position we took as a legal matter—comments such as the impact on the pension plans, the response of employers by not having pension plans, the impact on the industry, the health of the plans, et cetera. Those go beyond what we have considered thus far. We simply looked at the legislative history, the administrative rulings of the Department of Labor and the statute itself, and of course, the relevant case law.

But some of the comments we have received do raise some significant problems.

Senator GRASSLEY. So the problems that have been raised by your own staff study do not appear to you to be insurmountable, but obviously, there are some agencies outside yours who are raising questions that you consider very difficult issues to resolve?

Mr. THOMAS. That is right, yes.

Senator GRASSLEY. I wonder if we might not benefit at this point from maybe a couple of characterizations of one or two of the most serious ones you have heard raised by outside agencies.

Mr. THOMAS. I think probably the major one that was pointed out by the Pension Benefit Guaranty Board, as I read their staff comments, to increase the coverage of these plans to include post-normal accrual, will affect the health of a variety of the plans that are in place today and will actually provide a disincentive for employers having such plans in the future.

I think that that is, from my standpoint—and that is certainly not the intention of the Commission to actually hurt the older workers by wiping out the plan, but it is something that I think has to be considered when we look at the economic impact analysis.

Again, our decision was based upon the way that we read the statute and the legislative history, et cetera.

And of course, the other serious comments have to do with different interpretations of ADEA, the 1967 provisions as well as the amendments to ADEA, and the conflicts with ERISA, or the perceived conflicts with ERISA.

Senator GRASSLEY. Now, that is based on legitimate disagreement between agencies of what the law was intended to do; right?

Mr. THOMAS. That is right. We look at these statutes from different vantage points than Treasury.

Senator GRASSLEY. To some extent, then, our legislation would be helpful in resolving those issues; right?

Mr. THOMAS. I think the legislation would perhaps be in a posture where it gets around the legislative history portion of the problem, but it still has to deal with the impact on the existing plans and whether or not it creates a disincentive for having these plans, and thus resulting in an adverse impact or negative result for the older workers and the younger workers.

Senator GRASSLEY. What is your best estimate of when you will be able to publish the proposed regulations in the Federal Register for public notice and comment?

Mr. THOMAS. Let us put it this way. I think that we will probably be in a position to do that sometime in the late spring or early summer of 1986. Now, whether or not we are able to do that with coordination with OMB, et cetera, is a whole different matter. As a member of the executive branch, you learn not to assume that you can control OMB.

Senator GRASSLEY. OK. There again, if Congress considers this a serious issue that must be dealt with—and of course, the introduction of the legislation in this hearing is some indication of the seriousness that this subcommittee assigns to the issue—then we again could be helpful in resolving what otherwise might be an unresolved issue.

Mr. THOMAS. Again, Senator, I think that you can resolve the legislative history portion of it, the conflict there, but the portion that has to be grappled with and dealt with head-on is the impact of that change, and again, we have not done the economic impact analysis. There is significant disagreement as to what that impact will be, what the negative fall-out will be. The Pension Benefit Guaranty Board thinks one thing will happen; other people think that nothing will happen.

Senator GRASSLEY. Of course, we hope through this hearing to establish a record that will be beneficial to this subcommittee in making that determination, because obviously, we want positive results from the legislation, as we would want positive results from what you are trying to do as well.

Mr. THOMAS. Again, from our standpoint, the consistency between what you are trying to do and what our interpretation of the ADEA is that we both, I think, believe that the coverage should go beyond 65 to 70, under the ADEA.

I think, of course, you would resolve a lot of the underlying problems for us. Our decision simply came from a reading of ADEA as opposed to making a straightout policy decision.

Senator GRASSLEY. It is my understanding that the ADEA requires employers to maintain protection under fringe benefit plans until age 60, but they are allowed to equalize costs so that benefits for employees over age 65 do not cost more than benefits for employees at age 60 to 64.

Pension benefits are the exception, since they are currently exempted from that general requirement. Under your proposed rule, would employers be prohibited from equalizing pension plan costs as they now do with other types of fringe benefits?

Mr. THOMAS. I think our decision actually is consistent with the equal cost/equal benefit rule, in that we thought that the Department of Labor's I.B. was an exception to their equal cost/equal benefit rule, which had been in place for quite some time.

So again, we think our position is consistent with the equal cost/equal benefit rule.

Senator GRASSLEY. That is the end of my oral questions, but I do have some written questions that would deal with the impact of your proposed rules on certain existing pension practices that we will submit to you and ask you to answer in writing.

Mr. THOMAS. Thank you. We will do that.

Senator GRASSLEY. Thank you very much, Mr. Thomas.

Mr. THOMAS. Thank you, Senator.

[Information referred to follows:]

EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
WASHINGTON, D.C. 20507

OFFICE OF
THE CHAIRMAN

Honorable Charles E. Grassley
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

Thank you for the opportunity to expand upon my remarks of October 17, 1985, before the Subcommittee on Aging. This letter provides answers to the questions you raised in your letter of December 10, 1985.

1. What impact, if any, will the EEOC'S proposed rules have on the five - year rule, which allows a defined benefit or target benefit pension plan to exclude an employee who is first employed by the employer within five years of the plan's normal retirement age?

The Commission is in the process of reviewing its position regarding the "five-year rule." The Commission will determine its final position after coordinating the review with the other agencies affected. It is anticipated that the final position will have no impact upon current law.

2. What impact, if any, will the EEOC'S proposed rules have on "backloading" restrictions (i.e. the three percent method, the 133-1/3 rule, and the fractional rule) and integration requirements currently contained in ERISA and the Internal Revenue Code? Would the backloading tests apply to benefits accrued after an employee attains the plan's normal retirement age? If so, what would be the effect on an integrated pension plan with a maximum social security offset rate established at the plan's normal retirement age?

The Commission's proposed rules are not designed to address the issue of backloading of benefit accruals. The current Internal Revenue Service Regulations would not be affected.

In addition, the Commission's position with respect to the maximum permitted offset rate is consistent with the position promulgated in 1979 by the Department of Labor.

3. Under the EEOC'S proposed rules, how will plans that automatically begin to distribute benefits at normal retirement age be treated? Would they be required to continue to distribute benefits to active beneficiaries, or would they be exempt from the requirement to provide for the accrual of benefits after normal retirement age?

The Commission's proposed rules as drafted would not permit exemptions for plans that automatically begin to distribute benefits at the plan's normal retirement age. While a plan could commence the distribution of benefits to a participant at the normal retirement age, benefit accrual would be required to continue until the participant's actual retirement (or attaining the age of 70, if earlier).

4. Under the EEOC'S proposed rules, will benefit limitations not related to a plan's normal retirement age (e.g., a limit on the number of years of service recognized by the plan for benefit accrual purposes) be permitted?

The Commission's proposed rules would not affect the current practice in some plans of calculating benefits based upon years of service (not exceeding a stated maximum), assuming that the plan is a bona fide employee benefit plan which is not a subterfuge to evade the purposes of the ADEA.

5. If the EEOC'S proposed rules are adopted, will they take effect immediately, or will some leeway be permitted to allow employers time to amend their plans? Will the new rules take into account expiration dates in collectively bargained plans?

While the Commission has made no final determination regarding the mechanics of implementing the proposed rules, the issue of the potential need for a phase-in period is under study. In addition, provision could be made to take into account expiration dates in collectively bargained plans.

6. Will the EEOC'S proposed rules have any retroactive effect?

The Commission does not anticipate that the proposed rules would be given retroactive effect.

Sincerely,

/s/ Clarence Thomas

Clarence Thomas
Chairman

Senator **Grassley**. As our first panel, we are going to hear from Mr. Joseph Silvestri and Herbert Liebenson. As I said, Mr. Silvestri is currently the general attorney for the J.C. Penney Co. and will be testifying in behalf of the ERISA Industry Committee. And Mr Liebenson is president of the National Small Business Association.

I would like to have you, Mr. Silvestri, if you could, introduce your counsel for us.

Mr. **Silvestri**. Yes, Senator. On my left is John M. Vine, with Covington & Burling, the counsel for the ERISA Industry Committee.

Senator **Grassley**. OK. I would like to have you start out, Mr. Silvestri, and then Mr. Liebenson, and then we will have questions of both of you simultaneously.

STATEMENT OF JOSEPH M. SILVESTRI, GENERAL ATTORNEY, J. C. PENNEY, CO., ON BEHALF OF ERISA INDUSTRY COMMITTEE, ACCOMPANIED BY JOHN M. VINE, ESQ., COVINGTON & BURLING; AND HERBERT LIEBENSON, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. **Silvestri**. Good morning, Senator.

My name is Joseph M. Silvestri, and I am a general attorney in the legal department of J.C. Penney Co. I appear today on behalf of the ERISA Industry Committee, commonly referred to as ERIC. ERIC has filed a written statement which I respectfully request be incorporated into the record.

I would like to thank this subcommittee and its chairman for this opportunity to testify on this important issue. ERIC, as you may know, is an association of more than 100 of the Nation's largest employers, including my own company. ERIC's members retain retirement plans covering more than 9 million participants and beneficiaries. ERIC's views are representative of a wide cross-section of major plans in the private sector.

The issue as I understand it today which is the subject of these hearings is whether there should be contributions to retirement plans or service credit for employees who have attained normal retirement age and continue to work. Normal retirement age is usually 65.

Before the EEOC's recent attempts to rescind its current rule, the law was absolutely clear that employers could legally cease to make contributions and decline to recognize postnormal retirement service. ERIC believes that when Congress enacted the 1979 amendments to ADEA, it unquestionably endorsed the preservation of the current law. ERIC's written statement amply supports and documents this position, and I would not burden the committee with the legal arguments at this point in time.

But it follows from that point that EEOC has no authority, in our opinion, to reverse the rule of law that has clearly been approved by Congress, and it also follows that any change in this law can come from Congress and must come from Congress, not administrative agencies.

If Congress should decide to change the law, we respectfully recommend that several important points be given careful consideration. Our areas of concern involve: the effective date aspects of any change in the law; preservation of age-related aspects of current law, and the coordination with certain interrelated technical requirements of ERISA and the Internal Revene Code.

As to effective dates, if Congress again decides to change the law, we strongly recommend that the effective dates selected allow plan sponsors adequate time to comply. It should also, in our opinion, apply only prospectively. And in collective bargaining situations, we suggest that existing agreements be permitted to expire before the law to be applied. This approach would enhance an orderly transition in the change in the law. We submit that orderly change assures widespread voluntary compliance.

As to the preservation of certain age-related rules, if Congress decides to change the law, we urge that there be no change made to the provisions of ERISA or the Internal Revenue Code which currently permit employers to withhold pension plan eligibility to those workers hired within 5 years of normal retirement age. This rule makes it easier for older individuals and workers to gain employment. It allows employers to avoid inordinately high pension costs, which would discourage employment of older workers if there were not such a rule. The law on this point is sound, and it should not be changed, in our opinion.

If Congress decides to change the law, we also suggest that certain Treasury regulations or rulings be preserved. For example, currently, plan sponsors are allowed to distribute a retirement benefit when an employee attains normal retirement age, regardless of whether that employee actually retires or not. This would necessitate, for example, that Congress clarify that in such situations, the postnormal retirement accruals would not apply to such plans. It would be incongruous to have to pay out the benefit, on the one hand, and to accure service with respect to that benefit, on the other.

Likewise, under current law, retirement plan sponsors based on their economic situation, are free to set maximum limits on the amount of benefits accrued under a plan. For example, many plans have a maximum service recognition—30 years, for example—which therefore caps the benefit. This is not an age-related practice, and it should be preserved. Obviously, an employee working beyond normal retirement age should not be treated better than employees who have not reached normal retirement age in similar situations.

There are also technical provisions of ERISA which present some problems which we suggest should be addressed. For example, on the one hand, ERISA precludes backloading. Simply put, this is the requirement that accrual of pension service be the same, or at the same rate through a person's career; in other words, that it should not accrue at a higher rate or at a faster rate in the latter part of one's career as opposed to the early part of one's career.

At the same time, there are technical integration requirements required under the Internal Revenue Code. Under the maximum integration requirements, plans can set their maximum integration offset at normal retirement age. The interplay of these two rules could cause a problem for some employers. An employer's plan which has a maximum integration rate set at normal retirement age, if required at the same time to accrue benefits past normal retirement age would be on the horns of a dilemma. If it complied with the new law, or the changed law, it might very well run afoul of the backloading requirements.

We suggest that some relief in this area be addressed in any legislation.

In sum, we recommend that all of these points that I have addressed in my testimony be given careful consideration by Congress, and all of the committees of Congress charged with the responsibility for ERISA and the Internal Revenue Code in the retirement area.

Thank you.

[The prepared statement of Mr. Silvestri follows:]

ERIC

The
ERISA
Industry
Committee

STATEMENT OF

THE ERISA INDUSTRY COMMITTEE

BEFORE THE

SUBCOMMITTEE ON AGING

OF

THE COMMITTEE ON LABOR AND HUMAN RESOURCES

OF THE

UNITED STATES SENATE

ON

PENSION CONTRIBUTIONS AND ACCRUALS

AFTER NORMAL RETIREMENT AGE

October 17, 1985

My name is Joseph M. Silvestri. I am a General Attorney with J.C. Penney Company, Inc. I appear today on behalf of The ERISA Industry Committee ("ERIC").

ERIC is an association of more than 100 of the Nation's largest employers. ERIC's members maintain retirement plans covering more than nine million participants and beneficiaries. ERIC's views are representative of a wide cross-section of major plan sponsors in the private sector.

As the Subcommittee is aware, the Equal Employment Opportunity Commission (the "EEOC") has decided to rescind the current rule that allows a pension plan to cease contributions and the crediting of service for employees who have

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attained normal retirement age. A number of legislative proposals on this subject have also been introduced, including S.1472 and H.R.2712.

In brief, ERIC's position is that any change in current law should be made by Congress, not by the EEOC. The current law was recognized by both the Labor Department and Congress while the 1978 amendments to the Age Discrimination in Employment Act ("ADEA") were under consideration, and, in enacting the 1978 legislation, Congress emphatically endorsed the preservation of current law. The EEOC has no authority now to reverse a rule of law that has been approved by Congress.

Moreover, any change in the current rule regarding post-normal-retirement-age contributions and accruals should be carefully coordinated with the many, interrelated requirements that the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code impose on pension plans. These requirements are administered by the Labor Department and the Internal Revenue Service, not by the EEOC. If the EEOC's proposal were adopted by Congress, many of the applicable ERISA and tax law rules would require modification or clarification to take the change in the law into account. For this reason, no change should be made in current law until all Congressional committees with jurisdiction over ADEA, ERISA, and the Internal Revenue Code have considered the matter and a public law is enacted.

Specifically, we think that if the law is amended, attention should be given to the following concerns:

1. The amendment should not alter the provisions in ERISA and the Internal Revenue Code that allow a defined benefit pension plan to exclude employees who are hired within five years of the plan's normal retirement age.
2. The amendment should be coordinated with the anti-backloading and integration requirements of ERISA and the Internal Revenue Code.
3. The amendment should clarify its impact on a plan that provides for the commencement of benefits as soon as an employee attains normal retirement age, regardless of of whether he actually retires at that time.
4. The amendment should make clear that it does not require plan benefit formulas to be revised to provide benefits in excess of those called for under the plan's basic benefit formula (including any limit imposed by the plan on benefits or on the number of years of service that are recognized for benefit accrual purposes).

5. The amendment should not become effective prior to a date that gives plan sponsors and administrators sufficient time to comply with the amendment.
6. With respect to collectively bargained plans, the amendment should not become effective before the expiration of bargaining agreements in effect on the date of enactment.
7. The amendment should not have any retroactive effect.

Finally, in addressing these concerns, Congress should recognize that every plan sponsor has a limited amount of funds that it can spend on employee benefits. As a result, to the extent that an amendment to ADEA requires a plan sponsor to bear additional costs, the sponsor may find it necessary to reduce the benefits it provides to employees of all ages in order to reduce its employee benefit costs to an acceptable level.

EEOC's Lack of Authority

The EEOC cannot overturn a decision already made by Congress. The legislative history of the Age Discrimination in Employment Act Amendments of 1978 (the "1978 Amendments") makes it clear that Congress has previously ratified the Labor Department's view that ADEA does not require contributions or the accrual of benefits after an employee attains normal retirement age. The EEOC has no authority to overturn this prior Congressional decision.

In its report on the 1978 Amendments, the House Committee on Education and Labor emphasized that the amendments would not require additional benefits, benefit accruals, or actuarial adjustments after an employee reached normal retirement age:

> Nothing in these amendments would change the provisions of the Employee Retirement Income Security Act of 1974, and no additional requirements would be made of pension plan programs under these amendments.
>
> The Employee Retirement Income Security Act of 1974 (ERISA) now defines normal retirement age; this is usually age 65 or before, but may be later for persons beginning participation in the plan after age 55. Normal retirement is the age at which a worker receives full benefits, that is, benefits that are not actuarially reduced on account of early retirement. This bill would not change the definition of normal retirement age. These amendments do not require that any additional benefits, benefit accruals or actuarial adjustments be provided other than those required under ERISA.

H.R. Rep. No. 527, 95th Cong., 1st Sess. 9 (1977) (emphasis added).

The report of the Senate Committee on Human Resources on the Age Discrimination in Employment Act Amendments of 1977 included an exchange of letters between Senators Williams and Javits and Assistant Secretary of Labor for Employment Standards Donald Elisburg. Mr.

Elisburg's letter stressed that ADEA would not require benefit accruals or actuarial adjustments for an employee who worked beyond normal retirement age and that, as a result, an increase in ADEA's upper age limit from 65 to 70 would not increase the funding costs of private pension plans:

> It is our view that nothing in the ADEA or in the proposed amendments would require an employer to credit, for purposes of benefit accrual, those years of service which occur after an employee's normal retirement age . . .
>
> . . .
>
> An increase in the upper age limit of the ADEA would not increase the funding costs for private pension plans. As a matter of fact, financial pressure on private pension plans could be alleviated. Requiring an employer to permit a qualified employee to work until the Act's upper age limit, regardless of the pension plan's normal retirement age, would result in cost savings to plans rather than increases. As an actuarial matter, the longer an employee works, the shorter the period retirement payments will have to be made, thus lowering the funding assumptions of the plan. Savings would of course come from the added years of accumulated interest on the fund. Savings would also stem from the fact that, as indicated above, a plan need not provide for further accrual of benefits after the participant has reached the plan's normal retirement age, and thus the added years of service do not increase the ultimate retirement benefit or the cost of providing it.

S. Rep. No. 493, 95th Cong., 1st Sess. 15-16 (1977) (emphasis added).

The Senate Report indicates clearly that Congress intended Mr. Elisburg's views to be authoritative:

> The argument that pension and other employee benefit plan costs would increase if the act's upper age limit is increased has not been substantiated. At the hearings on this legislation, Donald Elisburg, Assistant Secretary of Labor for Employment Standards, assured this committee that officials in the Department of Labor who administer ERISA are in complete agreement that "there would be no interference with the relevant provisions of the 1974 pension law if the upper age limit were raised * * *"
>
> *This legislation would not change the definition of normal retirement age under ERISA. It does not require the accrual of additional benefits or the payment of the actuarial equivalent of normal retirement benefits to employees who choose to work beyond the plan's normal retirement date.*
>
> *Included in this report is a letter from Assistant Secretary Elisburg* responding in detail to questions from the Chairman and ranking minority member of the committee on the relationship between ERISA and the proposed amendments to the ADEA *which reaffirms the committee's intent in this regard*.

Id. at 5 (emphasis added).

Thus, it is quite clear not only that Congress was aware of the Labor Department's position concerning post-normal-retirement-age benefit accruals and actuarial adjustments, but also that Congress had adopted the Department's position as its own. The additional views of Senator Javits echo this view:

> Employers have also expressed concern that the costs of funding their pension plans will increase if the mandatory retirement age is raised. Our analysis, which has been supported by the Labor Department, is that pension costs will not increase and, in fact, will decrease if workers stay on the job past age 65. The longer an employee works, the shorter the period retirement payments will have to be made. Savings would also come from the added years of accumulated interests on the pension assets. *Additional savings would arise from the fact that a plan need not provide for further benefit accruals after the participant reaches the plan's normal retirement age*. Added years of service do not necessarily increase the ultimate retirement benefit or the cost of providing it.

Id. at 32 (emphasis added).

The House and Senate floor debates also reveal that Congress intended to adopt Mr. Elisburg's views regarding post-normal-retirement-age contributions and accruals. Mr. Elisburg's letter (which was also sent to Congressman Hawkins) was read into the Congressional Record during the House floor debates, 123 *Cong*. *Rec*. 30,564 (Sept. 23, 1977), and on March 21, 1978, Congressman Hawkins answered Congressman Dent's question concerning continued employer contributions past normal retirement age:

> Mr. DENT. Mr. Speaker, in order that there be no question about the committee handling of pension legislation, I have arranged with the gentleman from California to make the record very clear. I would like to put this question to the gentleman:

> Is it the intention of the conferees that an employer will be permitted, under the Age Discrimination in Employment Act of 1967 as amended, to maintain a defined contribution plan -- other than a plan which is merely supplemental to a defined benefit or defined contribution plan maintained by the employer -- which precludes employer and, if applicable, employee contributions to such a plan subsequent to an employee's attainment of the normal retirement age contained in the plan?
>
> Mr. HAWKINS. Yes. The answer to the gentleman's question is "Yes."
>
> The conferees intend that an employer will not violate the Age Discrimination in Employment Age by maintaining such a defined contribution plan. This position is in keeping with the general view of the House and the Department of Labor with regard to prohibited age discrimination in the context of pension plans covering employees who continue employment beyond the normal retirement age, as expressed in a letter of September 8, 1977, from Assistant Secretary Elisburg to me which appears in the Congressional Record of September 23, 1977, at page 30564.

124 Cong. Rec. 7881-82 (March 21, 1978) (emphasis added).

Likewise, on March 23, 1978, on the Senate floor, Senator Javits asked Senator Williams for clarification of certain issues raised by the 1978 Amendments:

> Mr. JAVITS. . . . Mr. President, if I may have the attention of the chairman of our committee and manager of the conference report on the floor, I wish to clarify a number of issues involving employee benefit plans and the Age Discrimination in Employment Act of 1967, as modified by the 1978 amendments. I want to ask our distinguished committee chairman whether he agrees that an employer will be permitted

> under the act, as amended, to maintain a defined contribution plan -- other than a plan which is merely supplemental to a defined benefit or defined contribution plan maintained by the employer -- which precludes employer and, if applicable, employee contributions to such a plan subsequent to an employee's attainment of the plan's normal retirement age.
>
> Mr. WILLIAMS. The answer is "yes." I completely agree with the statement of the distinguished Senator from New York. Your statements are consistent with the position taken by the Department of Labor regarding these matters. As assistant Secretary Elisburg's letter, which appears in the Senate committee report, makes clear, employers will not be required to continue contributions to either defined benefit or defined contribution plans for employees who continue working beyond a plan's normal retirement age.

Id. at 8218 (emphasis added).

Thus, it is clear that in enacting the 1978 Amendments, Congress adopted and relied upon the Department of Labor's view that ADEA does not require either contributions or benefit accrual after an employee attains age 65. The EEOC has no power to overturn that decision now.

Issues To Be Resolved

If Congress chooses to consider amending ADEA to require contributions and the accrual of benefits after an employee attains normal retirement age, the committees with jursidiction over ADEA, ERISA, and tax matters should give careful consideration to the issues raised by the amendment.

1. The Five-Year Rule. One issue is raised by the provisions of ERISA and the Internal Revenue Code that allow a defined benefit (or target benefit) pension plan to exclude an employee who is first employed by the employer within five years of the plan's normal retirement age. See ERISA § 202(a)(2); I.R.C. § 410(a)(2). In our view, any amendment to ADEA should make clear that no change would be made in the five-year rule. The five-year rule was adopted by Congress as part of ERISA in 1974 in order to make it easier for older individuals to obtain employment. Congress was concerned that the high cost of providing a pension for an employee who had nearly reached retirment age at the time he was hired would subject the employer to inordinately high pension costs and would, as a result, discourage employers from hiring older workers. See H.R. Rep. No. 1280, 93d Cong., 2d Sess. 262 (1974); H.R Rep. No. 779, 93d Cong., 2d Sess. 17, 45-46 (1974). The five-year rule permits older employees to be hired without subjecting employers to substantial additional pension costs. If ADEA is amended, the legislation should make it clear that the five-year rule will be preserved.

2. Backloading and Integration Requirements. Both ERISA and the Internal Revenue Code limit the extent to which the accrual of pension benefits may be "backloaded," i.e., earned in the later stages, rather than in the earlier

stages, of an employee's career. Section 204 of ERISA and section 411(b) of the Internal Revenue Code require a pension plan's benefit accrual provisions to satisfy at least one of three tests: the three percent method, the 133-1/3 percent rule, or the fractional rule. In the case of an integrated pension plan, under which benefits are offset by Social Security benefits, the Internal Revenue Service has ruled that if pension accruals continue after the maximum Social Security offset has been reached under the plan, the plan fails to meet any of the three backloading tests and is therefore impermissibly backloaded. See Rev. Rul. 78-252, 1978-1 C.B. 123.

It is not clear how, or to what extent, the backloading tests apply to benefits accrued after an employee attains the plan's normal retirement age. However, if the anti-backloading tests apply, an integrated pension plan with a maximum Social Security offset rate established at the plan's normal retirement age would be confronted with a dilemma: The plan's failure to increase the Social Security offset rate after normal retirement age (usually age 65) would cause the plan to be backloaded, while increasing the offset rate above the maximum level allowable would cause the plan to violate the Internal Revenue Service's integration requirements. See Rev. Rul. 71-446, 1971-2 C.B. 187. The employer's only alternative would be to amend the plan to provide that the maximum allowable offset rate would not apply until the employee reached age 70. Unless the revision in the offset rate were accompanied by a reduction in the plan's basic benefit formula, the result would be an increase in costs for the pensions of all employees, not just those over age 65. Congress should consider and address this issue before amending ADEA.

3. Commencement of Benefits at Normal Retirement Age. Current Treasury Department regulations and Internal Revenue Service rulings permit a pension plan to begin distributing benefits to an employee as soon as he attains normal retirement age, regardless of whether he has terminated employment at that time. See Treas. Reg. § 1.401(a)-11T (Q/A-4); Rev. Rul. 71-24, 1971-1 C.B. 114. If Congress amends ADEA to require the accrual of benefits after an employee attains the plan's normal retirement age, Congress should clarify the status of such plans: Will the anticutback rule of ERISA and the Internal Revenue Code require such plans to continue to distribute benefits to active employees who attain normal retirement age? See ERISA § 204(g); I.R.C. § 411(d)(6). If so, the employer might be required to recalculate and adjust the employee's pension each year to reflect the employee's additional service under the plan. Or will plans that automatically begin to distribute benefits at normal retirement age be

exempt from any requirement to provide for the accrual of benefits after normal retirement age?

4. No Additional Benefits. Any amendment to ADEA should make clear that an employee who has earned the maximum benefit under the plan will not be required to accrue additional pension benefits merely because he works beyond the plan's normal retirement age. An employee who works beyond the plan's normal retirement age should not be treated more favorably than all other employees and should be subject to the same limits that the plan's benefit formula imposes on employees generally (*e.g.*, any "cap" on the plan's benefit, or any limit on the number of years of service recognized by the plan for benefit accrual purposes).

5. Effective Date. The effective date of any amendment to ADEA should occur no less than 12 months after the amendment is enacted. Plan sponsors are only now completing the process of amending their plans to comply with the Tax Equity and Fiscal Responsibility Act of 1982, the Deficit Reduction Act of 1984, and the Retirement Equity Act of 1984. This process has been time-consuming, complex, and costly. If it decides to amend ADEA, Congress should recognize the burdens imposed by new laws that require pension plans to be amended every year or two. The amendment process not only imposes substantial costs on plan

sponsors, but also discourages the adoption of new plans and the continuation and expansion of existing plans. In view of the national policy of fostering the growth and success of the private pension system, any amendment to ADEA should have an effective date that gives plan sponsors enough "breathing room" after the most recent round of Congressionally-mandated amendments and enough advance notice that plan sponsors and administrators will have sufficient time to comply with the new law in a timely and orderly manner.

6. Collectively-Bargained Plans. Many pension plans are maintained pursuant to collective bargaining agreements under which pensions are only one of many negotiated items. It would be inequitable to apply a new rule under ADEA to employers that have entered into collective bargaining agreements in reliance on cost calculations that were based on the current law regarding the accrual of benefits after normal retirement age. Accordingly, any amendment to ADEA should adhere to the customary practice in Federal age discrimination and pension legislation of providing that the new rule will not become effective until the expiration of any applicable collective bargaining agreement that is in effect on the date of enactment. *Cf*. Age Discrimination in Employment Act Amendments of 1978, P.L. 95-256, § 2(b), 92 Stat. 189 (1978); Retirement Equity Act of 1984,

P.L. 98-397, § 302(b), 98 Stat. 1451; H.R. Rep. No. 527, supra, at 8-9; S. Rep. No. 493, supra, at 11.

7. Prospective Application. Any amendment to ADEA should be effective only for the future and should have no retroactive effect. Thus, if Congress decides to amend ADEA to require the accrual of benefits after normal retirement age, it should make it clear that the amendment will not require a plan to provide for the accrual of benefits with respect to employment completed before the amendment becomes effective. Retroactive application would impose substantial and unjustified burdens on plan sponsors who have been relying in good faith on prior law. Any form of retroactivity would be costly, inequitable, and contrary to what should be one of the basic goals of Federal pension policy: to provide a stable environment that will encourage the creation, continuation, and expansion of voluntary pension plans in the private sector. Cf. ERISA § 4002(a).

Senator **Grassley**. You know, the three points that you have brought up are not addressed in our bill, and to the extent to which they are not, and to the extent to which they ought to legitimately be considered, I hope it will be possible for you or your counsel maybe to sit with us later on, in the weeks ahead.

Mr. **Silvestri**. We would be happy to do that, Senator, to work with your staff and any members of the subcommittee to take these points into account.

Senator **Grassley**. I suppose first of all we have to make a determination as to their legitimacy, but after that we would want some input from you.

Mr. **Silvestri**. We would be happy to furnish any help we can in that area.

Senator **Grassley**. Initially, some input on greater understanding of those issues.

Mr. **Silvestri**. Certainly.

Senator **Grassley**. Mr. Liebenson.

Mr. **Liebenson**. Thank you, Senator.

My name is Herbert Liebenson, and I am president of the National Small Business Association, a multiindustry trade association representing approximately 50,000 small business firms nationwide.

Small business is slowly getting out of the pension business. Only 14 percent of workers in firms employing 1 to 24 are now covered by a pension plan, and I would hazard to guess that most of those are in multiemployer plans.

That compares with 72 percent covered in firms employing 500 or more. Furthermore, the percentage has been decreasing in recent years. One problem is that the rules and legal requirements for establishing an employer pension plan have simply become too complex for small business. Another is that the rules are changing at an ever-increasing pace so that no sooner has a plan been amended to meet one set of rules than they must again be amended to meet another set.

The very largest companies in the country assign staff employees to this task, continually modifying their pension plans to meet new Federal requirements. Small business does not have that luxury, and ends up either running plans that do not meet all of the Federal requirements, through inadvertence, or if the details are handled by some outside agent, the plan gradually requires such administrative detail or such heavy cost that the small business must abandon it.

In recent months, various White House State conferences on small business have emphasized the point I have just made about the complexity and the extremely high cost for a small firm to amend its pension programs.

The Age Discrimination Act was passed in 1978. At the time of passage, it was understood that it would not apply to pensions. The Department of Labor's interpretive ruling permitted employers to terminate pension accruals at normal retirement age. This was done so that individuals would not have a disincentive to retire. The law remains the same, and the problems remain the same. New political realities apparently require a reassessment of the problem, however.

The EEOC has thus decided that it should now require the continued accrual of pension credits even though the law has not changed.

Small business does not oppose continuing pension accruals for individuals working beyond normal retirement age. By far the vast majority of small businesses have defined contribution plans which have been required to carry such benefits forward anyway. We understand that under defined benefit plans the individual who goes on working after normal retirement age probably gives up as much in pension that he could have collected as he would be getting in added benefit accrual, so that the cost impact to the small business with a defined benefit plan would be minimal.

Accordingly, we do not oppose this change on grounds of principle, but we believe that Congress ought to agree to some sort of moratorium on these plans so they do not have to be changed annually.

Your bill, Mr. Chairman, S. 1427, would in our judgment be the proper way to proceed if the Government is going to now require pension accruals after normal retirement age. It seems improper, in our judgment, for such a change to be made by an administrative agency. If Congress intends that the change be made, Congress should certainly step up and make it. S. 1427 would require only that benefits continue to accrue up to the maximum under the plan for service rendered beyond normal retirement age. Small business supports this legislation.

H.R. 2712 introduced in the House by Mr. Biaggi would amend ERISA and the Internal Revenue Code, not only to allow benefit accrual past normal retirement age; it would also amend ERISA to permit employees hired within 5 years of normal retirement age to participate in retirement plans. This added change would have some negative implications not only for small business, but for older workers seeking employment.

Pensions cost a lot more for older workers than for younger workers. If two individuals, one age 55 and one age 65, are applying for the same position, the pension cost for the 65 year-old will be twice as much as the pension cost for the 55-year-old. In passing ERISA, Congress recognized that fringe benefit costs could discourage employers from hiring older workers. Thus, to some extent a requirement that newly hired employees must be included in the pension plan if they are hired up to normal retirement age rather than 5 years before as under present law would make the older worker more expensive to take on than a younger worker. This might discourage employment of older applicants. Most small businesses, of course, are not going to have actuaries around to tell them the cost differential involved in the various fringe benefit programs the employer has. The likely result, therefore, is that in the small business sector at least, workers will still be hired on the basis of what they can contribute, and if the small business is occasionally stuck with a high pension cost, this will be factored into the starting pay levels for such workers. Small business does not seriously oppose this change in participation requirement, but cannot support it on principle.

The rules adopted by EEOC are intended to make the workplace operate in a fair manner. Those rules are complicated enough as they stand, and small business is slowly learning what they mean. If they are changed at frequent intervals, many small businesses will end up inadvertently violating one or more of these rules.

Thus, we urge that the most careful consideration be given to changes that are made in these rules. Clearly, some changes will be necessary. In our view, annual changes are not desirable. When changes occur too frequently, it just makes the small business that has decided that it cannot offer a pension plan on grounds of complexity feel happy about the choice it has made.

In short, we do not wish to have continued acts of Congress and changes in regulations deter small business from providing its older employees with retirement income security.

Thank you.

[The prepared statement of Mr. Liebenson follows:]

STATEMENT OF HERBERT LIEBENSON
OF THE NATIONAL SMALL BUSINESS ASSOCIATION
TO THE
SENATE LABOR SUBCOMMITTEE ON AGING
HOLDING HEARINGS ON
THE OLDER AMERICANS' PENSION BENEFITS ACT
AND
THE OLDER WORKERS' EMPLOYMENT PROTECTION ACT

OCTOBER 17, 1985

Mr. Chairman and Members of the Committee:
My name is Herbert Liebenson. I am President of the National Small Business Association (NSB), a multi-industry trade association representing approximately 50,000 small business firms nationwide.

We appreciate the opportunity you have given to us regarding the Equal Employment Opportunity Commission's decision to rescind the Department of Labor's interpretive ruling on Section 4(f)(2) of the Age Discrimination in Employment Act. That section permits employers to terminate pension accruals for employees that work past normal retirement age.

Small business is slowly getting out of the pension business. Only 14% of workers in firms employing 1 to 24 are now covered by a pension plan. That compares with 72% covered in firms employing 500 or more. Furthermore, the percentage has been decreasing in recent years. One problem is that the rules and legal requirements for establishing an employer pension plan have simply become too complex for small business. Another is that the rules are changing at an ever increasing pace so that no sooner have plans been amended to meet one set of rules, they must again be amended to meet another set. The very largest companies in the country assign staff employees to this task of continually modifying their pension plan to meet new federal requirements. Small business does not have that luxury and ends up either running plans that do not meet all of the federal requirements through inadvertence or, if the details are handled by some outside agent, the plans gradually require such administrative detail or such heavy cost that the small business must abandon it.

The Age Discrimination Act was passed in 1978. At the time of passage it was understood that it would not apply to pensions. The Department of Labor's interpretive ruling permitted employers to terminate pension accruals at normal retirement age. This was done so that individuals would not have a disincentive to retire. The law remains the same and the problems remain the same. New political realities apparently require a reassessment of the problem, however. The EEOC has thus decided that it should now require the continued accrual of pension credits even though the law has not changed.

Small business does not oppose continuing pension accruals for individuals working beyond normal retirement age. By far the vast majority of small businesses have defined contribution plans which have been required to carry such benefits forward anyway. We understand that under defined benefit plans the individual who goes on working after normal retirement age probably gives up as much in pension that he could have collected as he would be getting in added benefit accrual, so that the cost impact to the small business with a defined benefit plan would be minimal. Accordingly, we do not oppose this change on grounds of principle but we do believe that Congress ought to agree to some sort of moratorium on these plans so that they do not have to be changed annually.

S.1427, which Senator Grassly has introduced, would, in our judgment, be the proper way to proceed if the government is going to now require pension accrual after normal retirement age. It seems improper, in our judgment, for such a change to be made by an administrative agency. If Congress intends that the change be made, Congress should certainly step up and make it. S.1427 would require only that benefits continue to accrue up to the maximum under the plan for service rendered beyond normal retirement age. Small business supports this legislation.

H.R.2712, introduced in the House on June 11 by Mr. Biaggi, would amend ERISA and the Internal Revenue Code not only to allow benefit accrual past normal retirement age, it would also amend ERISA to permit employees hired within 5 years of normal retirement age to participate in retirement plans. This added change would have some negative implications, not only for small business but for older workers seeking employment.

Pensions cost a lot more for older workers than for younger workers. If two individuals, one age 55 and one age 65, are applying for the same position, the pension cost for the 65 year-old will be twice as much as the pension cost for the 55 year-old. In passing ERISA, Congress recognized that high fringe benefit costs could discourage employers from hiring older workers. Thus to some extent a requirement that newly-hired employees must be included in a pension plan if they are hired up to normal retirement age (rather than 5 years before, as under present law), would make the older worker more expensive to take on than a younger worker. This might discourage employment of older applicants. Most small businesses, of course, are not going to have actuaries around to tell them the cost differential involved in the various fringe benefit programs the employer has. The likely result, therefore, is that in the small business sector at least, workers will still be hired on the basis of what they can contribute and if the small business is occasionally stuck with a high pension cost, this will be factored into the starting pay levels for such workers. Small business does not seriously oppose this change in participation requirement but cannot support it on principle.

The rules adopted by the Equal Employment Opportunity Commission are intended to make the workplace operate in a fair manner. Those rules are complicated enough as they stand and small business is slowly learning what they mean. If they are changed at frequent intervals, many small businesses will end up inadvertently violating one or more of these rules. Thus we urge the most careful consideration be given to changes that are made in these rules. Clearly some changes will be necessary. In our view, annual changes are not desirable. When changes occur too frequently it just makes the small business that has decided that it can't offer a pension plan on grounds of complexity feel happy about the choice it has made. In short, we do not wish to have continued acts of Congress and changes in regulations deter small business from providing its older employees with retirement income security.

Thank you

Senator GRASSLEY. Thank you both very much.

Now, if I address a question to a specific person, and the other witness has a comment to make on it, feel free to do so at the end of the answer of the person to whom I have directed the question.

Mr. Silvestri, I believe it was in your testimony that you raised concern with the impact of the mandatory post-65 accrual on certain other pension practices, for example, the 5-year rule and backloading and integration requirements. I believe that these concerns apply equally to the EEOC proposal and to the legislative proposals.

To your knowledge, have these concerns been addressed by the EEOC?

Mr. SILVESTRI. Senator, ERIC has made the comments to the EEOC, and apparently, they are not being addressed. And we have the same reservations with the EEOC's position. But our prime position is that the EEOC is without jurisdiction and authority to make this change, and that it is more appropriate for Congress to consider this matter.

Senator GRASSLEY. Also in your statement, you say that "A plan sponsor may reduce the benefits it provides to employees of all ages if amending the ADEA to require post-65 pension accrual results in additional cost."

As far as you know, is there any evidence that benefit reductions have taken place in plans that presently continue pension accruals after age 65?

Mr. SILVESTRI. I really do not have any hard evidence on that, Senator. The testimony was based upon general experience that when legislatively mandated costs are imposed upon plan sponsors, as human nature, if they have limited resources, they are going to find ways to offset those increased costs. And the obvious way is to reduce benefits and affect the whole host of employees as opposed to the employees who are being benefited by the changes which mandated increased costs. That is what I was addressing in my testimony, the natural human inclination where resources are limited.

Senator GRASSLEY. To both of you, for those employers who do not currently continue to accrue pension benefits after age 65, is it your sense that cost is the main consideration, or are other considerations involved? I will give you an example. For instance, a desire on the part of the employer to encourage retirement at age 65.

Mr. LIEBENSON. Well, I would say that in a small business, if an employee is kept after the age of 65, he is being kept mainly because of his skill and know-how within that particular industry. In most small businesses, there is not as clearcut or defined job classification. An employee must have the knowledge of two or three skills that he can utilize as the situation requires. Therefore, it would be rather difficult to bring in new employees and train them within a reasonable period of time; therefore, they tend to remain with the older employee.

It is much more of a family affair, if you please, in a small business than in a larger corporation.

Mr. SILVESTRI. If I understood the question, Senator—and I will base my answer based upon my corporate experience and my company's experience, because I really do not, again, have hard evidence beyond that on this point—at Penney's, we find that people retire at or around age 60 to 62, notwithstanding the fact that pension accruals obviously go beyond that. If that experience tells us anything, it tells me that people plan to retire for a whole host of reasons and that pension accruals perhaps are one of them, but it is certainly not in our case the primary reason. Otherwise, we would not have a pattern of retirement prior to normal retirement age at our company.

So I think the answer is, at least at my company, it is not significant.

Senator GRASSLEY. Also for both of the witnesses, this last question. Currently, about half of the defined benefit plan participants in medium and large firms voluntarily provide post-65 accrual for their workers. Would you tell us why a business might voluntarily provide post-65 accruals?

Mr. SILVESTRI. I would suppose that it would be the fact pattern, the work force makeup, the characteristics of the line of business, the availability of an employer to meet the perceived needs of its employees. These would be the principles which would dictate whether or not a company would want to credit post-65 accruals. That is my judgment.

Mr. LIEBENSON. I would agree with what Mr. Silvestri just said. And as I said just a short time ago, there is a much closer relationship between the small business employer and his employees, and the trend is to keep them on as long as they desire to work and are able to perform their function on the job.

A lot of the plans, as you well know, have a maximum of 30 years for accrual, and most often many firms allow their employees to work to that point; in fact, even beyond the 30-year accrual, they are not adding to the pension cost for the employer, and a lot of the employees prefer working.

Senator **Grassley**. I thank you very much. I ought to ask your counsel, Mr. Vine, if he had anything he wanted to add to any of these questions or even any general statement you might want to make?

Mr. **Vine**. No, Senator. I think Mr. Silvestri has covered all the salient points. But I would like to reiterate our willingness to work with the subcommittee and the staff in the future, should you see fit.

Senator **Grassley**. OK.

Mr. **Vine**. Thank you.

Senator **Grassley**. I would like to thank this panel and dismiss you and call the next panel.

Mr. **Silvestri**. Thank you, Senator.

Mr. **Liebenson**. Thank you, Senator.

Senator **Grassley**. I will now call the next panel: Mr. Losk, Mr. Kalman, and Ms. Andrews.

Mr. Losk is chairman of the pension committee of the American Academy of Actuaries. Mr. Kalman is an associate of William M. Mercer-Meidinger and will deliver a statement on his behalf and for another person, Ms. Rappaport. And then Emily Andrews is here to serve as a witness in her capacity as research director for the Employee Benefit Research Institute.

I would ask you to proceed in the order in which I have introduced you, please.

STATEMENT OF NORMAN S. LOSK, CHAIRMAN, PENSION COMMITTEE, AMERICAN ACADEMY OF ACTUARIES; ROBERT W. KALMAN, ASSOCIATE, WILLIAM M. MERCER-MEIDINGER, INC., AND EMILY S. ANDREWS, RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. **Losk**. Thank you, Mr. Chairman.

I am Norm Losk, chairman of the American Academy of Actuaries' pension committee. The American Academy of Actuaries is a professional organization of actuaries including about 85 percent of all enrolled actuaries practicing in the pension area in the United States.

Actuaries are people who are hired by plan sponsors to help them in dealing with the fiscal consequences of retirement programs. Essentially, actuaries do projections, statistical projections, of benefits expected to be paid, and using those projections, develop cost estimates which help sponsors to, in an orderly way, accumulate assets to liquidate pension obligations.

I would like, therefore, to talk a little bit about the cost impacts of the issue we are dealing with today; and second, to make a comment or two on plan design issues that exist.

There are really two separate issues in the legislation that are related but separate, relating to cost. First, we have the question of postnormal retirement accrual for individuals who are long-term participants in retirement programs.

Senator **Grassley**. Excuse me. Could you suspend for just a minute while I go to the phone, please?

Mr. **Losk**. Yes, Senator.

[Short recess.]

Senator Grassley. Thank you. Please continue.

Mr. Losk. Basically, as relates to the cost implications of the proposals, I would like to divide the issue into two, the first being ongoing accrual of benefits after normal retirement for people who have been long-term participants in the plan; second, the issue of participation of persons within 5 years of the normal retirement date in a plan.

Our written statement indicates that research in the actuarial profession has told us that there are several optional methods by which the postretirement accrual situation has been handled to date. One is to freeze the accruals. And naturally, freezing accruals without increasing accrued benefits after retirement for working persons actually reduces pension cost to an extent.

A second method is the continued granting of accruals, and given the impacts of advancing age, even the continuing accrual of benefits under the plan's formula, in most cases is a slight cost reduction as opposed to retirement at 65.

There is a third method by which this question is handled, and that is something called actuarial increases. This involves a freezing of accruals at age 65 or at normal retirement, but with a postretirement adjustment of benefits to equalize costs, so that the cost of the benefit, regardless of when it starts, is identical to the cost that would have been incurred at age 65.

So I think it can be said that in most cases in defined benefit pension plans, the cost of postretirement accruals or actuarial increases is at most a wash in relation to retirement at 65.

The question of plan participation by persons within 5 years of normal retirement at hire is a separate question. Essentially and simply, these are people who would not otherwise have participated in the plan, and any benefit accrued by those individuals would increase the cost of pensions in those situations, particularly, as Mr. Liebenson said, with a short period of time over which to accumulate funds to support those benefits.

A second general point on cost is that deferral of retirement past normal retirement has not been a major phenomenon in the private pension world. As has been indicated before, deviation from normal retirement has most often involved earlier retirement rather than later retirement. As a result of the fact that not a large percentage of people retire at a later point than normal retirement, the overall cost impacts on pension plans as a whole have been minimal. That situation could change. Demographics could change in future years to invite later and later retirement, but the trends we see currently do not indicate that.

Now, to the question of plan design, basically, retirement plans are normally designed to replace income. The person retiring is no longer working, conceptually, and as a result, the income from employment needs to be replaced by something else, and that is the retirement benefit.

From the standpoint of income replacement, several questions are raised, the primary of which is the question of whether or not the income replacement needs of a 67-year-old retiree are different or the same as the income replacement needs of an age 65 retiree. That is a question that is currently being answered by employers in the designs of their plans, and as has been indicated, there is a good deal of variation in the way that question has been handled in their plans to this point.

Thank you very much. I would be happy to answer any questions.

[The prepared statement of Mr. Losk follows:]

STATEMENT TO THE SUBCOMMITTEE ON AGING OF THE SENATE LABOR AND HUMAN RESOURCES COMMITTEE POST-RETIREMENT AGE PENSION ACCRUALS

NORMAN S. LOSK
PENSION COMMITTEE
AMERICAN ACADEMY OF ACTUARIES

OCTOBER 17, 1985

The American Academy of Actuaries appreciates the opportunity to comment on the issue of requiring employers to continue making pension contributions and crediting service under ERISA for employees who work beyond normal retirement age. The Academy is a professional association representing over 7,800 actuaries in all areas of specialization. Membership includes 85% of the total number of enrolled actuaries who are qualified under ERISA.

The Academy does not advocate a particular position regarding post-retirement age benefit increases under pension plans. We recognize that there are several possible views of this issue and we hope to provide information and informed opinions on matters that should be considered in any discussion of it. The Academy has also submitted comments to the Equal Employment Opportunity Commission (EEOC) in response to that agency's request for comments on the possible revision of rules under the Age Discrimination in Employment Act (ADEA).

PLAN COSTS FOR POST-65 ACCRUALS

The impact on the actuarial costs of a pension plan due to deferred retirement is significantly affected by the choice of actuarial assumptions and cost method. In a great many instances, the impact of working beyond age 65 is typically not isolated in the actuarial computations because it would not be significant in the context of the operation of the plan as a whole. This is not to say that it would be insignificant if there was in the future a major shift in ages at which individuals actually retire.

Actuarial Value of Plan Benefits

The impact on the actuarial present value of benefits, for various methods of adjusting plan benefits is oulined briefly below. For a plan which provides a benefit equal to a percentage of final five year average salary for each year of service, the following generalizations may be made with respect to an employee who has completed twenty-five years of service:

1. If there is no additional service credit granted, the actuarial present value of the benefit payable from the plan decreases at a rate of approximately 10% - 12% per year during the period that the employee defers retirement.

2. If there is additional service credit granted but average salary is not allowed to increase, then the actuarial present value of the benefit declines at a rate of approximately 7% - 10% per year.

3. If additional service credit is granted and average salaries are allowed to increase, then the actuarial present value of the plan benefits declines at a rate of 2% - 4% per year.

4. If benefits are simply allowed to grow "actuarially", then there is no increase or decease in the actuarial present value of the benefits.

5. If the employee's benefit is allowed to grow with (a) actuarial increases, (b) additional service credit, and (c) increases in average salary, then the actuarial present value of benefits will grow at a rate of approximately 8% - 12% for each year of deferral.

All of the above are based upon investment return and salary increase assumptions which are well within the range of assumptions in common use. It is important to note, however, that the impact will vary according to the plan's assumptions, and can vary to a major extent based upon an employee's service and his or her actual growth of earnings in situations where average earnings are allowed to increase after age 65. Similarly, the plan of benefits can have an important impact on changes in costs.

Actuarial Assumptions Relating to Retirement Age

Actuaries have over the years tended to base the funding of most pension plan retirement benefits upon the assumption that employees will retire at age 65, the normal retirement age for most private plans. A major exception is often found in the funding of plans which allow earlier commencement of pensions on a basis which is financially favorable to employees. In these situations, an assumption concerning early retirements is often found. This is so because if the actuary were to ignore the existence of (for example) unreduced benefits at an earlier age, such as 62, this could lead to systematic underfunding and underestimation of the long term costs of the plan.

Another exception to assuming that retirement occurs at age 65 is found in the assumptions for those plans where there is an established history of a significant proportion of the employees working beyond age 65. In that instance the actuary might assume that a certain proportion of employees would work until an older age than the "normal retirement age." Ordinarily, however, caution would be used in selecting the retirement assumption if it materially reduced recommended funding levels relative to assuming employees will retire at age 65.

The 1978 Amendments to the Age Discrimination in Employment Act (ADEA) increased from 65 to 70 the age at which most employees can be required to retire. For a variety of reasons the impact on actual retirement patterns may have been minor to date, and the pattern of retirement which will emerge in the future is not clear. What is known is that for most private pension plans the funding of plan benefits based upon assumed retirement ages greater than age 65 would reduce plan funding requirements. We believe that many (if not most) actuaries would be reluctant to recommend reduced plan funding based upon an assumption that employees will work beyond age 65 without some evidence that this is in fact a reasonable expectation.

Added Costs of Post-Age 65 Benefit Adjustments

The analysis described above focuses on changes in pension costs relative to retirement at age 65. Another valid approach to this issue is to examine the opposite view — what is the actual added cost of changing present requirements for pension plan design. That is, it would be the view of some that there is now no requirement that benefits be adjusted for work beyond age 65, and that the imposition of any requirements in this area necessarily adds to costs. This would be so because the cost of a plan which provides larger benefits must be greater than otherwise. Here it is important to distinguish between (a) actuarial costs which are based upon actuarial estimates, and (b) actual costs of providing benefits. The former refers to the costs that the sponsor currently recognizes each year based upon actuarial valuations, and which often coincides with actual cash contributions to the plan.

These actuarial costs are dependent upon the actuary's assumptions. From this perspective, for example, actuarial adjustments to benefits have no effect on "costs" if the actuary assumes employees retire at age 65. Each time an employee works beyond 65, the actuarial adjustment to his or her benefits prevents the occurrence of an actuarial gain which would otherwise have reduced future funding requirements, but the "cost" is not identified.

The opposing view is that a change in interpretation of the act and its legislative history which would require benefit increases of any kind necessarily adds to the true cost of the plan. From this perspective the actuarial cost of a pension plan is recognized for what it actually represents -- an estimate that provides a reasonable and rational manner of budgeting for actual costs which cannot be known in advance.

While we express no opinion on the appropriateness of requiring benefit increases for service beyond age 65, we feel it is important to point out that a policy change which required the payment of larger benefits necessarily involves greater costs for the sponsor.

PENSION BENEFIT DESIGN ISSUES

Defined Benefit Pension Plans-Two Views

1. Deferred Compensation Viewpoint

At one extreme there is the view that defined benefit pension plan benefits are in all material respects deferred compensation plans. According to this view, an employee who works beyond age 65 should not "lose" any of the value that accrued to him or her before the plan's normal retirement age, and in fact he or she should be allowed to accrue further service credit beyond age 65 in addition to the full value of benefits "earned" before that age.

According to this view, the lump sum actuarial value of the employee's accrued benefit determined at age 65 (or possibly some earlier age when unreduced benefits are available) should be treated as if it belonged to the employee. This lump sum should then accumulate with interest to be converted to a larger retirement income at a later date of the employee's choosing.

Furthermore, it may be asserted that the employee should be entitled to earn further plan benefits while continuing to work.

2. Income Replacement/Protection Concept

At the other extreme, defined benefit pension plans are viewed as a form of income replacement protection for employees who retire after having met certain criteria -- attained a certain age (whether it be 55, 60, 62, 65, etc.) and completed certain service requirements. According to this view, the employer should be able to design his plan to provide that level of income replacement which the sponsor desires. ERISA and IRS regulations place certain constraints on benefit design; however, those rules do not prohibit the sponsor from providing the same level of retirement benefit across a wide range of ages — for example, all ages from 65 to 70.

According to this view, an employee who does not elect to retire has no claim to foregone benefits he or she might have received upon retirement. If the "protection" viewpoint is adopted, the situation can be considered analogous to a health insurance plan which makes no provision to pay amounts to individuals who do not incur covered medical expenses, a life insurance program that pays no benefits other than upon an employee's death, and a disability plan which pays benefits to only those who become disabled.

Issues raised by these two divergent views of defined benefit plans are not readily resolved. It has been common practice for employers to adopt (or maintain) the second view (or to assume its validity), and it appears to many to be permitted by the legislative history and current interpretations of the 1978 Amendments to the ADEA. Adoption by the EEOC of the first view (or of some intermediate position) would necessarily seem to be a repudiation of the validity of the second view with possible consequences beyond the seemingly simple question of whether or not retirement benefits must be increased for periods worked between age 65 and 70. For example, will identical reasoning be applied to plans which pay unreduced retirement benefits at age 62 or 60 or 55? Will this reasoning apply to benefits not customarily considered part of the "basic plan benefit" — for example, temporary retirement income benefits payable between retirement and age 62 (or age 65) which are designed such that total retirement income benefits, including Social Security, are more nearly level?

Currently pension accruals are permitted (by ERISA) which are greater in the early years of employment and lesser in the later years. This approach is commonplace and permits employees to have greater security at an earlier age than would be the case if uniform accruals were mandatory. This enables a mobile workforce to have deferred vested pensions which in total may be larger and this can help offset for inflationary erosion.

Many pension plans provide for a lower benefit accrual rate after 20 or 30 years of service, and may in fact provide for no credit beyond that point. This point frequently occurs within the 40 to 65 age range, and therefore many plan participants protected by the ADEA do not accrue benefits. If sponsors were required to provide a uniform accrual at all ages, one possible consequence is the prospective reduction of accruals at younger ages rather than larger benefits for older employees. If the EEOC contemplates requirements for benefit accruals among employees in the protected ages then we believe that this issue needs to be addressed.

We do not offer answers to the questions raised above because we do not believe that objective answers exist. The answers decided upon by individual sponsors are found in the manner in which their plans operate -- some have adopted the first view, some have partially adopted the first view (for example for basic benefits, but not "supplemental" benefits), and most employers have adopted an approach which is consistent with the second view.

Defined Contribution Plans

Similar arguments may be developed concerning contributions to defined contribution plans. One view is that there is no justification for stopping contributions at a particular age when the cost is the same as for a younger employee at the same salary or wage level. The opposing view is that the employer may establish retirement income goals for the plan, and contributions are structured based upon actuarial estimates to meet the sponsor's goals by a certain age (usually age 65). According to the second view the employer is justified in stopping contributions at that age even if the employee continues to work.

If the Income Replacement/Protection viewpoint relating to defined benefit plans is accepted by the EEOC, then should this second view of defined contribution plans be found unacceptable? If so, will sponsors of defined contribution plans reduce contributions for all participants to meet retirement income targets at an older age?

We do not feel it appropriate for the Academy to offer answers to these questions; however, we do believe it appropriate to raise the issues so that consideration can be given to the many issues that are involved in areas being addressed by the Commission.

Additional Comments on Special Early Retirement Benefits

Many pension plans enable employees who have met certain requirements to retire before reaching age 65 and to receive benefits which have a greater value than the accrued plan benefit payable at age 65. Examples include plans which allow employees to retire with unreduced benefits at age 60 or 62 provided certain service requirements have been met (10 years, 20 years, 30 years, etc.). If the employee continues to work beyond that age, there may or may not be additional service credit earned.

We wish to call this situation to the attention of the Subcommittee because discussions about the application of the ADEA to pension plans tend to focus upon the issues related to benefit accruals (or lack of them) after age 65. For those plans which do offer benefit commencement before age 65, the same issues appear to be relevant from an earlier age. That is, if a plan allows an employee to retire at age 62 (or 60, 55, etc.) with unreduced benefits, and the employee chooses to retire at age 65 with a benefit which has a lesser value (due to the shorter period over which it will be paid) the sponsor will also need to be advised whether this will be considered a discriminatory practice under the ADEA.

We also wish to call to the attention of the Subcommittee the fact that special early retirement benefits may be contigent upon employer actions such as reductions in force, plant closing, and so on, and may not be available to an employee under normal circumstances. Thus, if some special pension accrual and/or actuarial adjustment requirements are adopted by the EEOC, it will be helpful to sponsors to know whether a distinction will be allowed for benefits payable to employees whose early retirement benefits are contingent upon events not fully within the individual employee's control.

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Senator **Grassley**. Mr. Kalman.

Mr. **Kalman**. Thank you, Mr. Chairman.

My name is Robert Kalman. I am an associate with the employee benefit and compensation consulting firm of William M. Mercer-Meidinger, Inc., and I am located in Mercer-Meidinger's Washington, DC office. I am testifying here today on behalf, of my colleague, Anna M. Rappaport, of our Chicago office, and myself.

We recently completed a study for the American Association of Retired Persons. This study analyzes the cost of mandating pension accruals for employees age 65 through 69. Details of our findings are contained in the written statement that we have submitted to the subcommittee for the record. I would like to take this opportunity to summarize our statement.

Our study for the worker equity department of the American Association of Retired Persons analyzes the additional costs that would be incurred if employers were required to continue crediting pay and service in both defined benefit and defined contribution plans for post-65 through 69 employees. The results are based on estimates of the total number of employees who would receive additional benefits if this change were implemented, and reflects the actuarial methods used in determining employer contributions to pension funds in the United States. We constructed a computer model to develop these cost estimates. Cost is considered from two standpoints—first, the total present value of the additional pension benefits to be paid, and second, the additional annual employer contributions to pension funds. The additional annual contributions reduced by taxes reflect the effect of this rule change on total corporate earnings.

Data have been developed based on two different assumptions—one, age 65 through 69 employment would be unchanged, and two, age 65 through 69 employment would increase since this would act as an inducement for employees to continue working beyond age 65.

It is estimated that there are 640,000 employees currently age 65 through 69 working full-time in firms covered by ADEA. Of this group, 42 percent are covered by defined benefit plans, half of which freeze benefits at age 65. This study shows the estimated cost of granting continued pension credit to these 134,000 employees. Costs are shown for, first, granting additional years of service without requiring that increased pay be recognized in calculating final average earnings, and then second, granting additional years of service, including increased pay, in calculating final average earnings.

Our model estimates that an additional 37,000 employees could receive increased benefits if pay as well as service had to be counted. Costs also include the cost of continuing benefits to 79,000 employees participating in defined contribution plans that freeze plan contributions at age 65.

This study also analyzes the cost effect on both employers and the Social Security System in the unlikely event that post-65 pension contributions and crediting serve as incentives for encouraging more employees to delay their retirement. The cost estimates are based on the assumption that additional people who continue working as a result of the change in regulation or law would be covered by defined benefit plans and that none of these plans currently credit service for work beyond age 65.

Our principal findings were: First, that the total annual value of pension benefits lost because employers do not grant full pension credit to those employees working beyond age 65 is approximately $450 million. Second, if there is no increase in the number of employees over age 65, and pension plans provide contributions and crediting, the increase in employer cost in the first year would amount to $51.5 million, less than one-tenth of 1 percent of total U.S. pension costs.

Exhibit 1 of our written statement shows that over 20 years, the annual employer cost increase would remain under 1 percent.

Our third general conclusion was that as the number of employees over age 65 increases, employer pension costs will decline, since the cost of continued contributions and crediting is more than offset by gains that result from the shortened duration of pension payments. This is shown in exhibits 6 and 7 of our written statement.

For example, if post-65 employment increases 25 percent, employer costs would decline by $16.9 million by year 5, and even more in later years. If post-65 employment were to increase by 50 percent, employers would realize an annual pension savings of more than $600 million by year 15, despite the cost of post-65 contribution and crediting.

Finally, if post-65 pension contributions and crediting encourage more employees to work beyond age 65, substantial Social Security benefits would not be paid.

The study conservatively estimates in 1985 dollars that if age 65 through 69 employment increases by 10 percent, yearly Social Security benefits not paid would be $295 million; with a 25-percent increase in employment, benefits not paid would be $739 million, and $1.5 billion with a 50-percent increase in employment.

The details of these findings can be found in our written statement and our report. I would prefer to stop here and answer any questions that you may have.

Thank you.

[The prepared statement of Mr. Kalman follows:]

WILLIAM M.
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Prepared Statement

Cost of Mandating Pension Accruals for Employees Aged 65 through 69

By

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Submitted to the

Subcommittee on Aging
Committee on Labor and Human Resources
United States Senate

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William M. Mercer-Meidinger, Incorporated

This statement is being submitted by Anna M. Rappaport and Robert W. Kalman. We are consultants with the employee benefit and compensation consulting firm of William M. Mercer-Meidinger, Incorporated. Anna M. Rappaport is a Principal with Mercer-Meidinger and is located in the firm's Chicago office. She is a Fellow of the Society of Actuaries and, for many years, has undertaken extensive research and numerous consulting assignments related to retirement and demographic issues. Robert W. Kalman is an Associate with Mercer-Meidinger and is located in the firm's Washington, D.C. office. He has extensive experience with public policy issues related to employee benefit plans and Social Security.

Background

The Age Discrimination in Employment Act of 1967 (ADEA) protects employees between the ages of 40 and 70 from age discrimination in all terms and conditions of employment. Current administrative interpretations of the law, however, allow an employer to discontinue pension contributions and crediting for employees who work beyond the age of 65.

Many believe that the practice which permits pension benefits to be frozen or suspended is contrary to the purposes of the ADEA and acts as a barrier to the continued employment opportunities of older workers. Frequently, this practice has been justified on the grounds that requiring such accruals would be costly to employers, thereby discouraging them from hiring or retaining older workers.

There are both legislative and regulatory proposals to require continued pension contributions and crediting for employees who work past normal retirement age. There has been, however, a dearth of empirical information to help pinpoint the costs of requiring employers to continue post-65 pension contributions.

Several years ago William M. Mercer-Meidinger, Incorporated analyzed the economic effect of various alternatives for handling pension benefit accruals after normal retirement age in defined benefit pension plans. Anna M. Rappaport was the author of that study, titled Cost Implications under Various Alternatives for Handling Retirement Benefit Payments Deferred Beyond Normal Retirement Age. The study showed that those employees who continue to work beyond age 65 do not receive the same value of pension benefits that the plan would have paid had they retired at the normal retirement age. This is because: (1) the ultimate pension paid to employees who delay their retirement is not adjusted to include service and pay beyond age 65; and (2) the value of benefits not paid between age 65 and actual retirement is not recovered during retirement.

A few plans that provide actuarial equivalent increases spend the same amount for employees who delay retirement as for those who retire at age 65. If benefits are adjusted on an actuarial equivalent basis, then the benefit received at retirement is increased by an amount that, on average, will compensate the employee upon actual retirement for benefits lost while working after age 65; the employee would receive a higher monthly pension benefit than he would have received at age 65. On this basis, employees who work an additional year beyond age 65 can expect to receive approximately a 12% increase in benefits; employees who work two more years can expect about a 27% increase; those who work five years can expect an 87% increase. The actuarial equivalent increase is not used by many plans and, conceptually, does not fit well within the framework of the defined benefit plan, which bases benefits on a prescribed formula.

About one half of all plans offer no additional benefit to employees who continue working beyond age 65. The employee receives the same dollar benefit at actual retirement as that person would have received at age 65. The plan experiences an actuarial gain equal to the benefits that have not been paid, and this amount reduces employer plan costs over a period of years.

Under proposed Equal Employment Opportunity Commission (EEOC) regulations, employers would be required to continue crediting service to employees aged 65 through 69. Pending legislation would require employers to continue crediting service to employees regardless of age.

If EEOC regulations were implemented or if pending legislation were enacted, there would be no immediate increase in the amount employers have been contributing to defined benefit plans. This is because private pension plans already are being funded for normal retirement at age 65 or earlier, and the value of normal retirement benefits exceeds the value of benefits received at delayed retirement. Gradually, there would be modest increases in cost over current levels because employers no longer would be receiving the full savings from later retirement which they are currently realizing. Employers that previously had employees working beyond age 65 would realize savings from delayed retirements, even if service after age 65 were credited. Those employers that already had employees working beyond age 65 and were not being credited for their additional service would experience cost increases since their savings from delayed retirement would decrease.

AARP Study

The Worker Equity Department of the American Association of Retired Persons (AARP) engaged Mercer-Meidinger to prepare a study which analyzes the costs of mandating employers to grant pension credits to employees aged 65 through 69. The results of that study , titled Cost of Mandating Pension Accruals for Employees Aged 65 through 69, are summarized herein. Anna M. Rappaport and Robert W. Kalman are the consultants who conducted this study for the AARP.

Specifically, this study analyzes the additional costs that would be incurred if employers were required to continue crediting pay and service in both defined benefit and defined contribution plans for post-65 through 69 employees. The results are based on estimates of the total number of employees who would receive additional benefits if this change were implemented, and reflects the actuarial methods used in determining employer contributions to pension funds in the United States.

This study also analyzes the cost effect on both employers and the Social Security system in the likely event that post-65 pension contributions and crediting serve as incentives for encouraging more employees to delay their retirement. The cost estimates are based on the assumption that additional people who continue working as a result of the change in regulations or law would be covered by defined benefit plans and that none of these plans currently credit service for work beyond age 65.

The major findings of the study follow.

1. The total annual value of pension benefits lost because employers do not grant full pension credit to those employees working beyond age 65 is approximately $450 million.

2. If there is no increase in the number of employees over age 65 and pension plans provide continued contributions and crediting, the increase in employer cost in the first year would amount to $51.5 million, less than one tenth of one percent (0.08%) of total U.S. pension costs. As Exhibit I shows, over twenty years the annual employer cost increase would remain under 1%.

3. As the number of employees over age 65 increases, employer pension costs will decline since the costs of continued contributions and crediting is more than offset by gains that result from the shortened duration of pension payments. For example, if post-65 employment increases 25%, employer costs would decline by $16.9 million by year five and even more in later years. If post-65 employment were to increase by 50%, employers would realize annual pension savings of more than $600 million by year fifteen, despite the cost of post-65 contributions and crediting.

4. If post-65 pension contributions and crediting encourage more employees to work beyond age 65, substantial Social Security benefits would not be paid. The study conservatively estimates (in 1985 dollars) that if age 65 through 69 employment increases by 10%, yearly Social Security benefits not paid would

be $295 million; with a 25% increase employment, benefits not paid would be $739 million; and $1.5 billion with a 50% increase in employment.

2. Discussion of Major Findings

Mercer-Meidinger constructed a computer model to develop these cost estimates. Cost is considered from two standpoints: (1) the total present value of the additional pension benefits to be paid; and (2) the additional annual employer contributions to pension funds. The additional annual contributions, reduced by taxes, reflect the effect of this rule change on total corporate earnings. Data have been developed based on two different assumptions: (1) age 65 through 69 employment would be unchanged; and (2) age 65 through 69 would increase since this would act as an inducement for employees to continue working beyond age 65.

It is estimated that there are 640,000 employees currently aged 65 through 69 working full time in firms covered by ADEA. Of this group, 42% are covered by defined benefit plans, half of which freeze benefits at age 65. This study shows the estimated cost of granting continued pension credit to these 134,000 employees. Costs are shown for: (1) granting additional years of service without requiring that increase pay be recognized in calculating final average earnings; and

(2) granting additional years of service, including increased pay, in calculating final average earnings.

The model estimates that an additional 37,000 employees could receive increased benefits if pay as well as service had to be counted. Costs also include the cost of continuing benefits to 79,000 employees participating in defined contribution plans that freeze plan contributions at age 65. These employees are economically disadvantaged by the current situation. For some employees, the freezing of benefit accruals at age 65 can have significant bearing on their financial well being during retirement.

Consider two employees who continue working beyond age 65 but have their pension benefits frozen at that age. Employee A earns $15,000 at age 65 and Employee B earns $25,000. Exhibits II and III show the loss in the value of their lifetime benefits under two scenarios: (1)if they work until age 67; and (2) if they work until age 70. At age 67, it is estimated that each employee would lose about 21% of the lifetime value of their pension because benefits were frozen at age 65 and they would be receiving those benefits for a shorter period of time than if they retired age 65. At age 70, the lifetime loss would be 44%.

A cost analysis also has been developed to show the effect of an increase in the 640,000 post-age 65 through 69 work force should a change in federal rules encourage more people to delay retirement. These costs estimates assume that additional employees who continue working beyond age 65 because of such a rule change would be covered by defined benefit plans, and that none of these plans currently credits service for work beyond age 65.

The study presents three different scenarios to illustrate the increase in employer cost if additional employees choose to continue working. The three scenarios are based on a 10% increase in total employment at ages 65 through 69 over current levels, a 25% increase, and a 50% increase. No prediction was made about how many employees would change their behavior. Such a prediction would require analysis of the retirement decision, and the many other factors in addition to employer-provided pension benefits that affect individual retirement decisions. The purpose of this analysis is to show how costs would change should behavior change.

Exhibit IV shows the number of employees over age 65 divided between those who have no defined benefit plan coverage, those with coverage and continued pension credits, and those with coverage but no accruals. Costs shown in the study reflect age 65 through age 69 accruals for those with pension coverage but with no accruals beyond age 65. The first bar in the graph shows results where there is no change in employment. The next three bars show results for the three scenarios where employment increases. Exhibit V shows similar data for defired contribution plan coverage. It should be noted that the same employees can be covered by both types of plans. We have assumed in our analysis that a change in the retirement decision would be influenced by the introduction of continued pension credit in the defined benefit plan.

In 1983, employers contributed $64.8 billion dollars to pension and profit sharing plans. The method of paying for pension plans gradually would recognize the cost of such a change so that it would not be fully recognized until 15 years had passed.

The largest increase in cost for mandatory pension accruals from age 65 through 69 would occur if there is no increase in employment at ages over 65. The reason for this is that employers are already realizing the savings from freezing pension benefit accruals at age 65 for employees who continue working. The additional costs (in 1985 dollars) under such a scenario follow.

Years after Implementation	CREDIT SERVICE ONLY Cost in Millions	 Percentage Increase in Total Cost	CREDIT PAY AND SERVICE Cost in Millions	 Percentage Increases in Total Cost
		Before-Tax Cost		
One Year	$ 52	.08%	$ 52	.08%
Two Years	78	.12	101	.16
15 Years*	335	.52	589	.91
		After-Tax Cost		
One Year	$ 28	N/A	$ 28	N/A
Two Years	42	N/A	54	N/A
15 Years*	181	N/A	318	N/A

* Same result applies in all later years.

Exhibits VI and VII show the percentage increase in annual employer pension cost in the United States if pension credits were mandated. Results are shown for different periods. After costs are fully recognized in year 15 and later, total U.S. pension costs increase by slightly over one half of one percent if employers are required only to credit service and if no increase in post-65 through 69 employment occurs. If crediting of service and recognition of pay in final average earnings calculations were required, total pension costs increase by slightly under one percent.

If employment increases, the total increase in employer pension costs will be less since the employer will experience gains from delayed retirement. These gains will more than offset the increases in cost due to crediting of service for the additional employees. The effect on individual employers will vary from these averages depending on their particular employee populations.

Changes in before-tax costs for employment increases of 10%, 25%, and 50% are shown below. It is assumed that 100% of the employees who changed their behavior have defined benefit coverage in plans that previously did not credit service. The number of additional employees are 64,000, 160,000, and 320,000, respectively.

	CREDIT SERVICE ONLY		CREDIT PAY AND SERVICE	
Years after Implementation	Cost in Millions	Percentage Increase in Total Cost	Cost in Millions	Percentage Increases in Total Cost
	10% Additional Employment			
One Year	$ 57	.09%	$ 57	.09%
Two Years	64	.10	94	.15
15 Years*	132	.20	467	.72
	25% Additional Employment			
One Year	$ 64	.10%	$ 64	.10%
Two Years	43	.07	84	.13
15 Years*	(174)	-.27	282	.44
	50% Additional Employment			
One Year	$ 77	.12%	$ 77	.12%
Two Years	8	.01	68	.10
15 Years*	(682)	1.05	(25)	-.04

* Same result applies in all later years. Amounts in ( ) are savings.

The effect on the economy of these additional employer pension fund can be viewed as a shift from corporate dividends and retained earnings to capital investment, since the amounts contributed to the pension funds are invested through the capital markets. There also is a reduction in corporate taxes equal to the tax on the additional contributions.

William M. Mercer-Meidinger, Incorporated

EXHIBIT I

% Increase in Employer Pension Cost

Mandated Pension Accruals

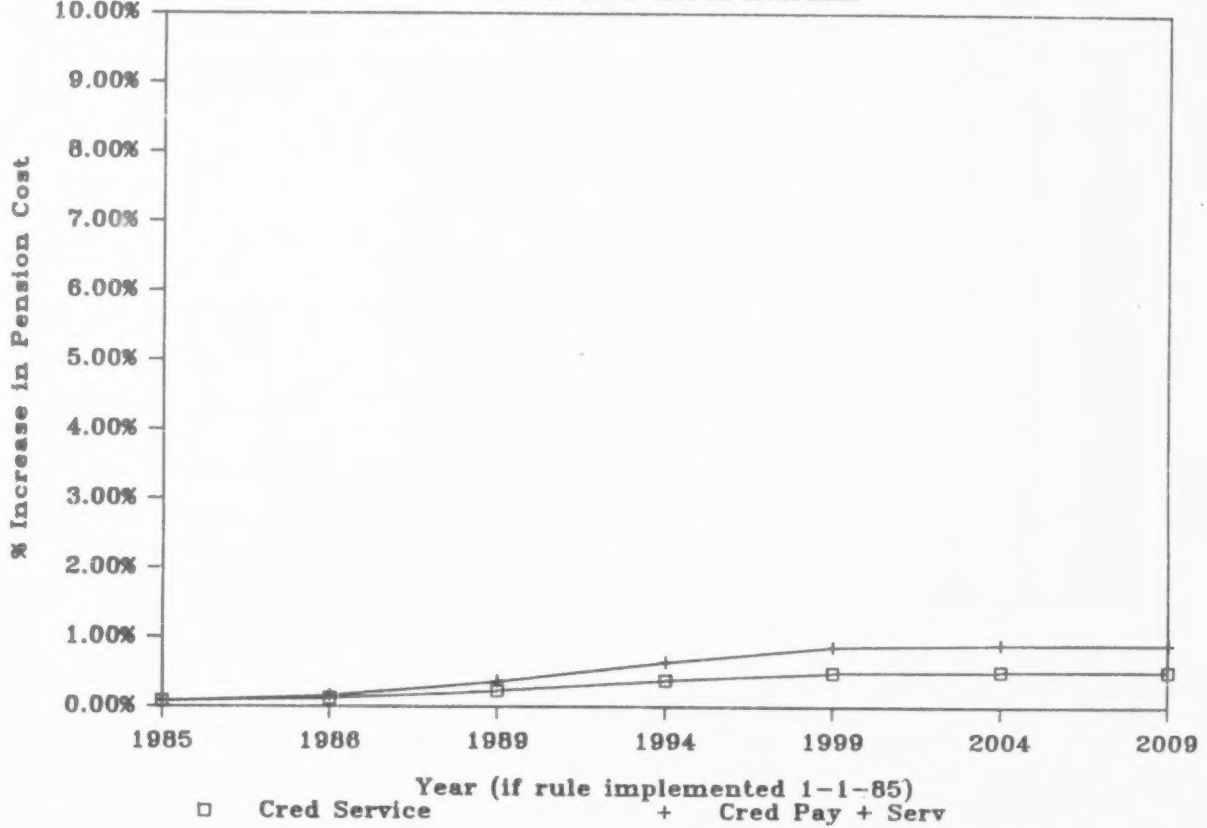

EXHIBIT II

Value of Benefit at Retirement

$15,000 Employee – Benefit Frozen at 65

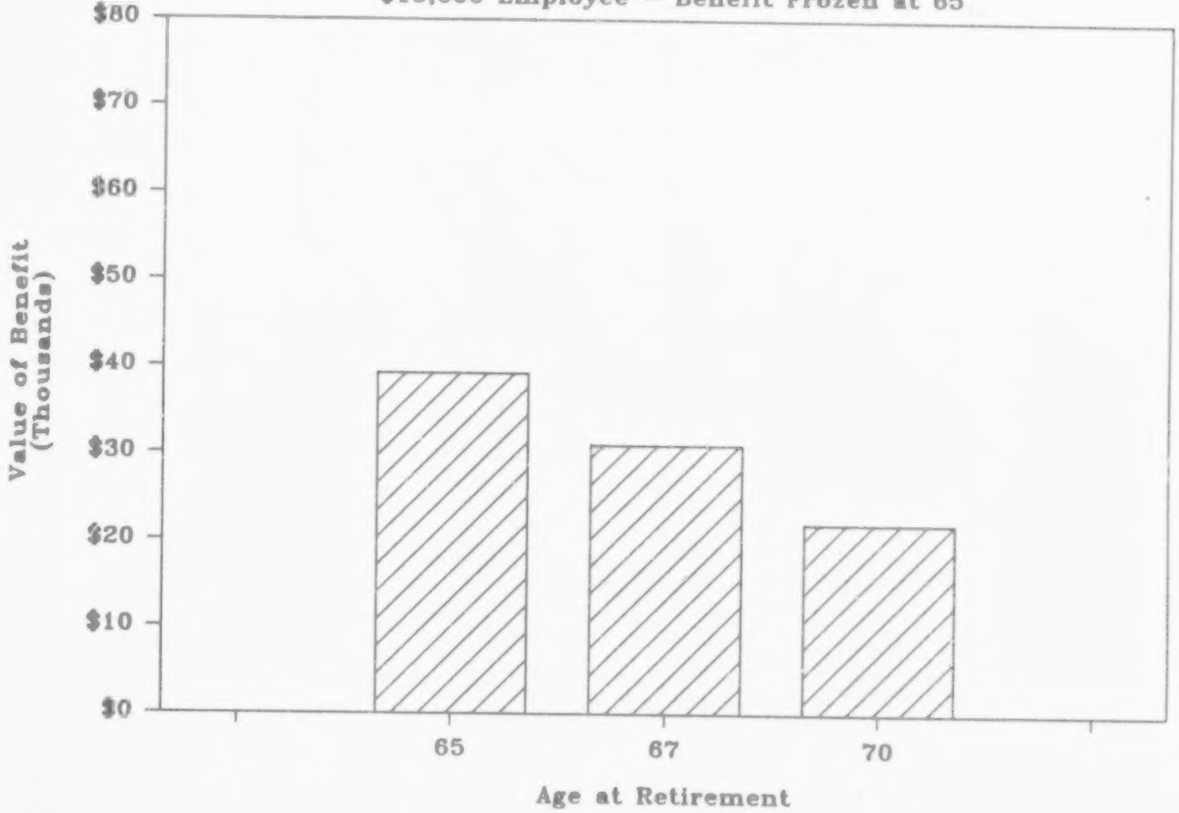

EXHIBIT III

Value of Benefit at Retirement

$25,000 Employee – Benefit Frozen at 65

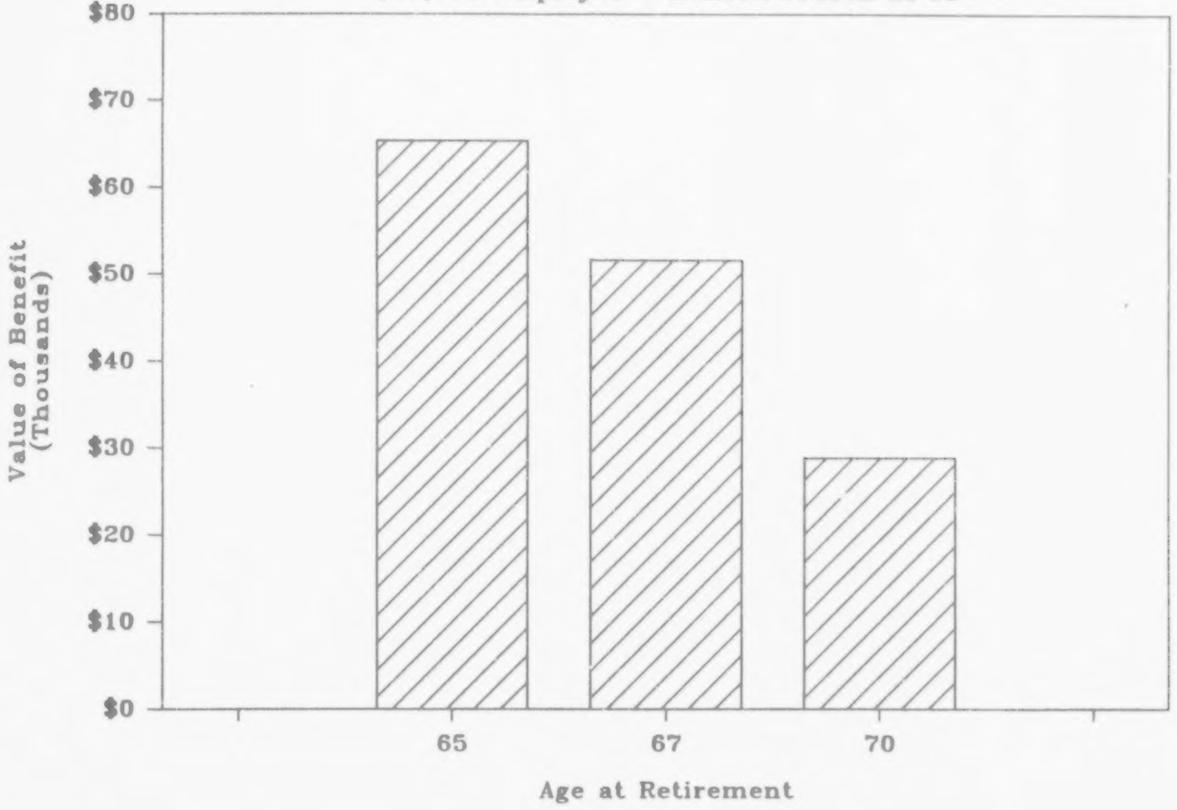

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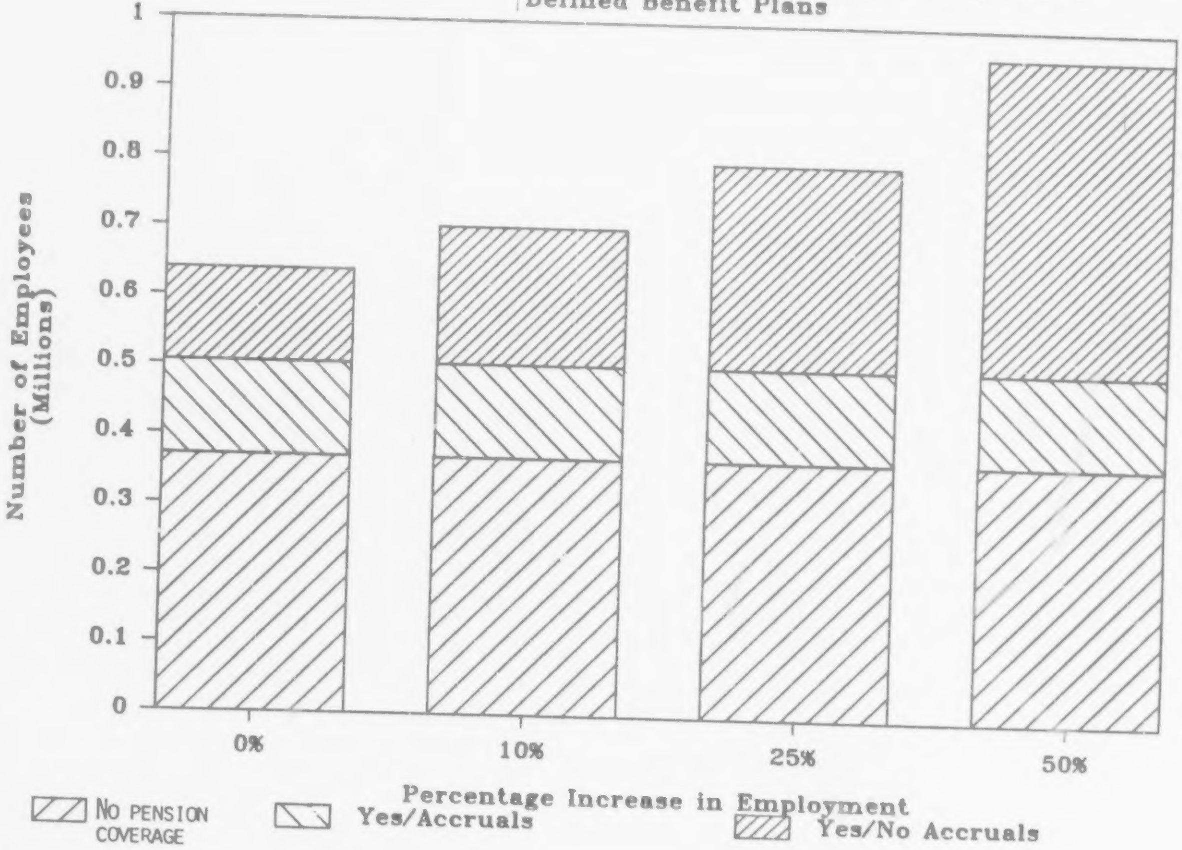
EXHIBIT IV

Coverage of 65–69 Employees

Defined Benefit Plans



William M. Mercer-Meidinger, Incorporated

EXHIBIT V

Coverage of 65–69 Employees

Defined Contribution Plans

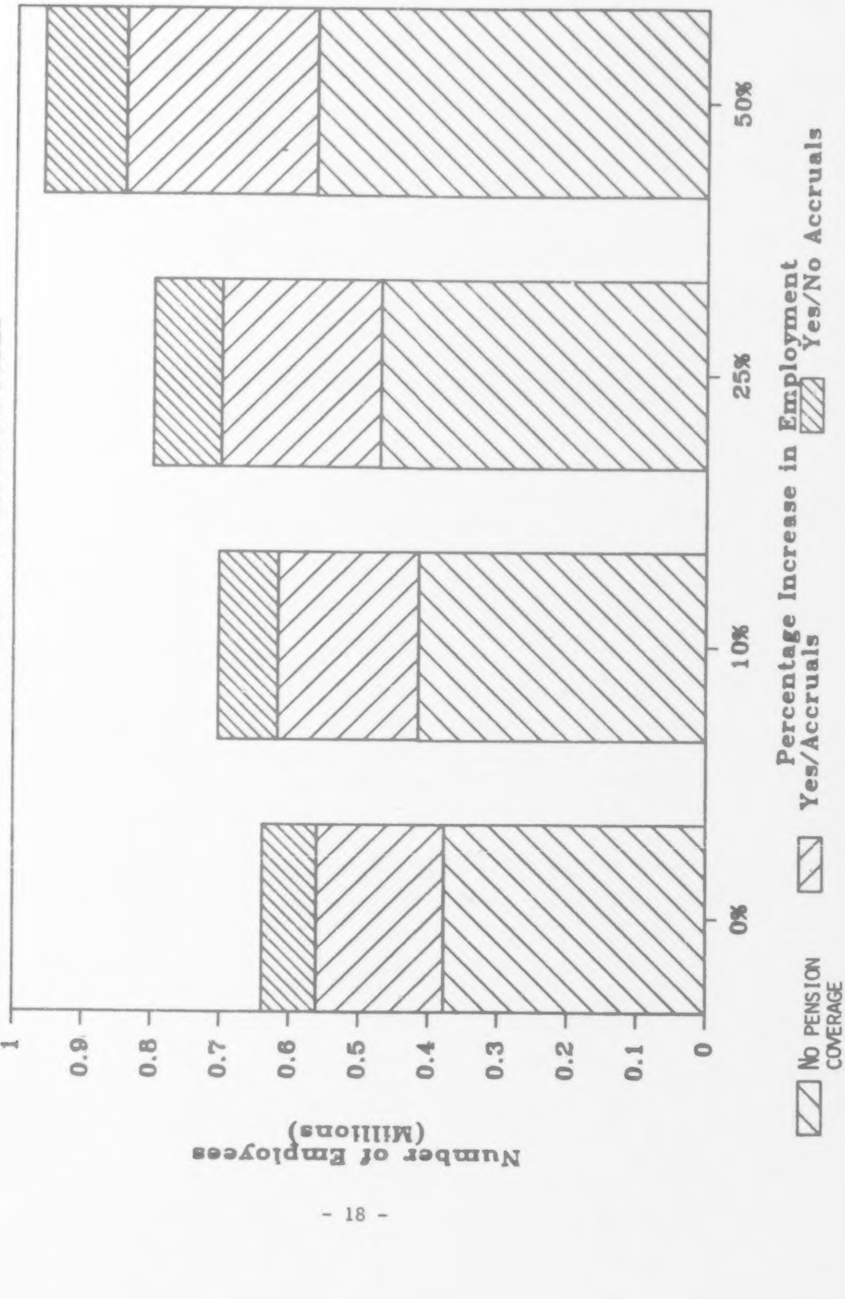
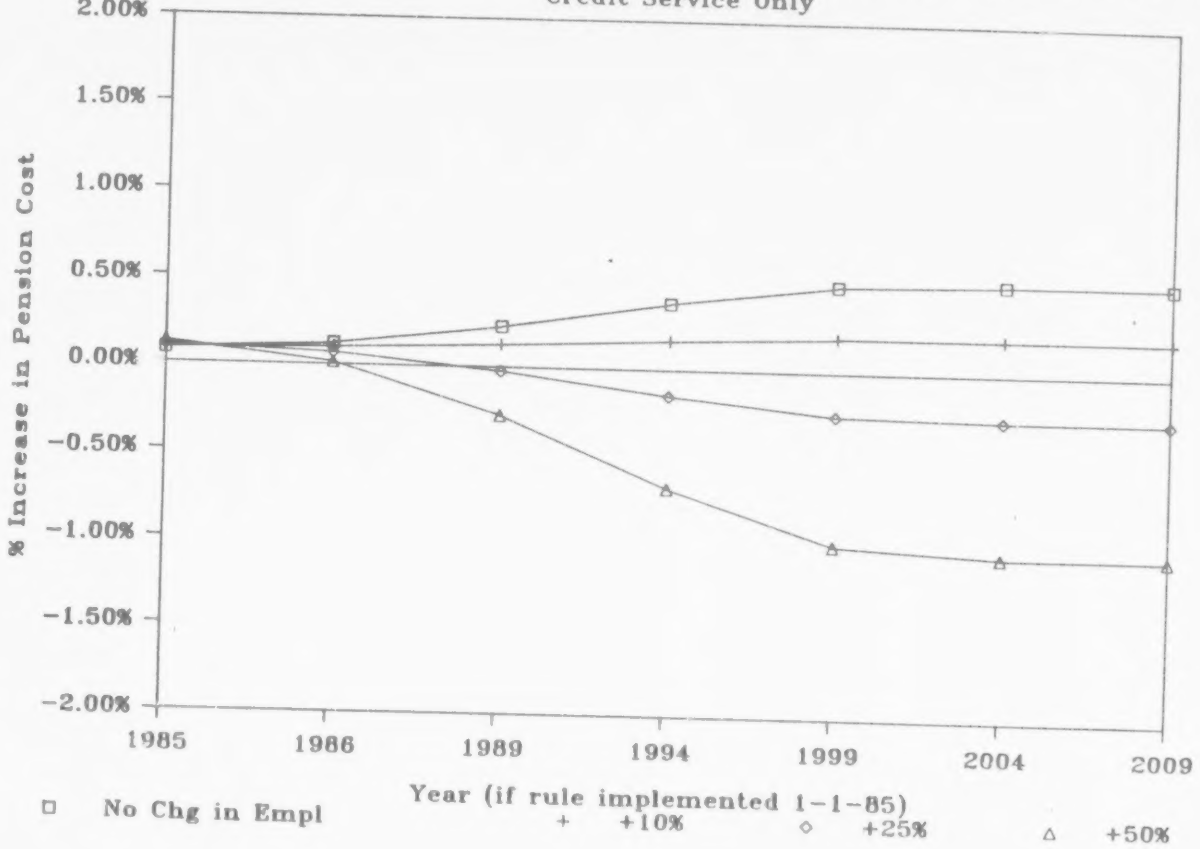


EXHIBIT VI

Effect of Various Employment Scenarios

Credit Service Only



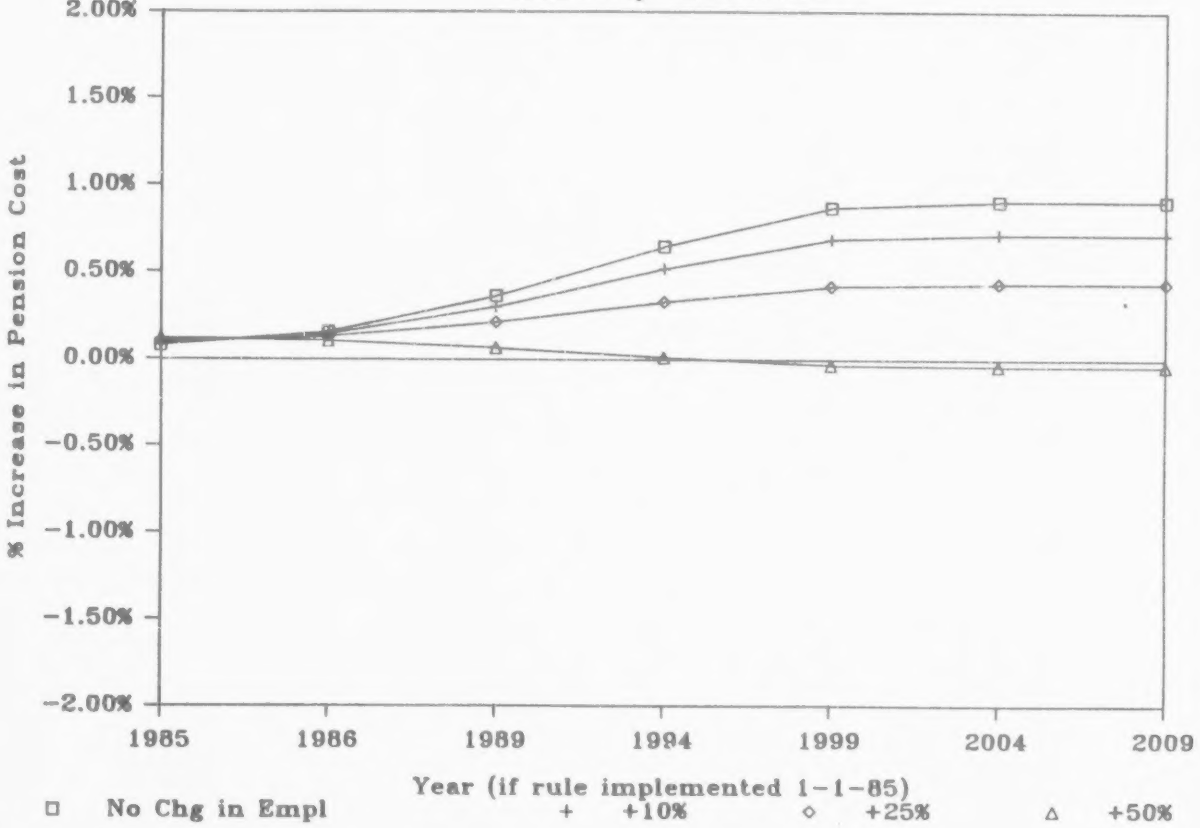
William M. Mercer-Meidinger, Incorporated

William M. Mercer-Meidinger, Incorporated

EXHIBIT VII

Effect of Various Employment Scenarios

Credit Pay and Service



Senator GRASSLEY. Ms. Andrews.

Ms. ANDREWS. Thank you, Mr. Chairman.

My name is Emily Andrews. I am research director at the Employee Benefit Research Institute.

I am pleased to appear before this subcommittee during its consideration of pension accruals and the older worker.

EBRI was formed in 1978 as a nonprofit, nonpartisan policy research institute, in order to conduct research and educational programs in the benefits area. My comments are set within this framework, and they should not be construed as endorsing any particular policy to either encourage or discourage pension plan accruals for older workers.

I plan to discuss four topics: How pension plans currently treat post-65 accruals; how many workers would benefit; how much workers might lose without those accruals, and what types of nationwide costs there might be.

Post-65 pension accruals are primarily an issue for private-sector defined benefit pension plans. In 1984, according to the Bureau of Labor Statistics, 50 percent of defined benefit participants in large- and medium-sized firms had some type of post-65 accruals. Only about 5 percent of plan participants received actuarially adjusted pensions at delayed retirement. In other words, these adjustments would increase the participant's pension payments so that the present value of pensions at later retirement would be the same as the present value at early retirement. In this case, the participant does not lose any of the asset value of the pension.

Nonetheless, there would be relatively few workers who would benefit from post-65 accruals. The reason for this is that now relatively few elderly persons choose to work after age 65, and the proportion has been declining substantially since Social Security was passed 50 years ago. For instance, even in 1960, the labor-force participation rate of men age 65 and older was 33 percent. This rate has declined precipitously so that in 1984 it was only 16 percent.

Most of the economic studies of retirement find that the economic factors of pensions and Social Security income have had a strong effect on people's decisions to retire. In fact, the pension system as we know is has met its objectives, both in terms of employers and in terms of employees, by encouraging such retirement.

As a result, provisions for continued accrual of workers 65 and older will affect a limited number. According to the nationwide survey EBRI conducted in 1983, out of a population of 25 million people 65 and older, somewhat less than 3 million persons were nonfarm wage and salary workers who might have participated in a pension plan.

We updated these figures for 1985 and found that the number of plan participants was only 365,000. Of these participants, about 182,000 are probably in plans with some provision for continued accruals, and the other half are not. Of the ones that are not, there are only about 151,000 persons who are entitled to benefits. This is a relatively small fraction of the labor force who would be helped by post-65 accruals.

How much might these workers lose? Depending on the plan provisions, ERBI analysis has found that participants can lose between 4 and 23 percent of the present value of their accrued lifetime benefits, unless these benefits are actuarially adjusted for delayed retirement. However, if people are valuing their pensions correctly, they will tend to retire when the value of their retirement income is at its highest; in other words, the way people do usually before 65. By this argument, the people who have not retired at this point have other reasons to continue their employment.

If continued pension accruals change the age at which retirees can receive this maximum income, more older workers can be expected to stay on the job. However, I submit that based on studies that economists have made of the 1983 Social Security Amendments, very, very few people would be encouraged to retire later. Employer costs are likely to be higher for those older workers who retire later, but employers could ease the pressure of higher costs in some way, for instance, by salary adjustments.

As long as we have these types of market adjustments, the real economic effect of continued accruals is very hard to evaluate fully.

What are the nationwide costs? Many have said the costs to employers of someone retiring at age 65 tend to be higher than the costs to employers of employees delaying retirement. However, actual benefits paid to someone who has decided to retire after normal retirement age would be increased by post-65 accruals compared to what they would get otherwise.

EBRI has presented a range of estimates of benefit costs from $280 million per year to higher estimates of $638 million and $1.3 billion. I might add that these later estimates are based on both continued accruals and actuarially equivalent benefits.

In any case, all of these numbers are quite small compared to about $65 billion of annual employer pension contributions. Whether additional contributions would be made by any particular plan depends on the plan's actuarial assumptions and also on their funding criteria.

In conclusion, because relatively few employees are affected, it could be argued that this legislation should be evaluated primarily from a civil rights perspective. There are possible indirect effects for older retirees in terms of changing the compensation system if costs are higher, and also if employers decided to ratify the Social Security amendments by other measures at some point to increase retirement, their costs for later retirees would be higher with accruals than without accruals.

In its debate, Congress will surely balance the advantages and disadvantages to older workes from this legislation. In sum, I think that both the benefits and costs in an economic perspective are relatively small in nationwide terms.

Let me also add that EBRI is currently putting together a monograph on older worker issues, which we would be glad to supply you when it is completed.

Thank you.

Senator GRASSLEY. Will that be ready shortly?

Ms. ANDREWS. It should be ready shortly, yes. I think we have an October or early November deadline.

Senator GRASSLEY. We would welcome that. Thank you very much.

[The prepared statement of Ms. Andrews follows:]

EBRI

T-51

Statement on

Pension Accruals for Older Workers

Before the United States Senate
Committee on Labor and Human Resources
Subcommittee on Aging

Hearings on Pension Accrual and
the Older Worker
October 17, 1985

of
Emily S. Andrews
Research Director
Employee Benefit Research Institute

The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research Institute, its officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a nonprofit, nonpartisan, public policy research organization.

Emily S. Andrews earned her Ph.D. in economics from the University of Pennsylvania. Before joining EBRI she held policy research positions at the Social Security Administration and the U.S. Department of Labor.

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STATEMENT

INTRODUCTION

Mr. Chairman, my name is Emily Andrews. I am research director at the Employee Benefit Research Institute (EBRI). I am pleased to appear before this Subcommittee during its consideration of pension accruals and the older worker.

EBRI was formed in 1978 as a nonprofit, nonpartisan, public policy research organization to conduct research and educational programs. EBRI is committed by charter to the premise that the nation is served in social and economic terms by the existence of employee benefit programs. We are aware that there may be limits to what can and should be provided and that changes in the system may be necessary to ensure benefit adequacy. Consequently, EBRI undertakes studies and provides statistics so that informed decisions can be made upon the assessment of documented costs and benefits.

My comments are set within this framework. They should not be construed as endorsing any particular policy to encourage or discourage pension plan accruals for older workers.

The issue of whether employer-sponsored pension plans should be required to continue pension contributions beyond normal retirement age has received increasing attention over the past two years. After the passage of the 1978 Age Discrimination in Employment Act (ADEA) in 1978, which prevented mandatory retirement before age 70, the Department of Labor (DOL) was directed to issue comprehensive interpretation of the ADEA Amendments with respect to employee benefit plans. In May 1979 the Labor Department issued a bulletin stating that the ADEA Amendments did not alter existing ERISA provisions allowing employers to freeze pension accruals after the plan's normal retirement age, which is frequently set at age 65. These provisions were intended to encourage employers to hire and retain older workers. Employees under 18 years of age and those working fewer than 1,000 hours in any year also do not have to be included in the firm's pension plan.

After the Equal Employment Opportunity Commissions (EEOC) assumed jurisdiction over the administration of ADEA, it started to review all DOL interpretations of the Act. In early 1985, the EEOC approved draft regulations that would require continued pension contributions, and hence larger monthly retirement benefits, for employees who work beyond normal retirement age.

Legislation has also been proposed to amend the ADEA to require post-65 accruals. On April 4, 1984 Representative Mario Biaggi (D-NY) introduced legislation which would require post-65 accruals; new legislation with additional provisions regarding plan participation provisions for older workers was introduced by Representative Biaggi on June 11, 1985. In addition, on July 11 1985 Senator Charles E. Grassley (R-IA) introduced legislation to amend the ADEA to ensure continue pension accruals under both defined benefit and defined contribution plans.

I plan to discuss four topics in my testimony today:

- How pension plans currently treat post-65 accruals;
- How many workers would benefit from requiring post-65 accruals;
- How much workers may lose without continued accruals;
- What are the nationwide costs of continued accruals.

PLAN PROVISIONS FOR POST-65 EMPLOYMENT

Post-65 pension accruals primarily are an issue for defined benefit and target benefit private pension plans. In defined benefit plans, the employer agrees to provide a specified monthly benefit at retirement which is usually tied to the employee's earnings and length of service. A target benefit plan is a defined contribution plan in which contributions are scaled to meet a specified retirement benefit. Post-65 benefit accruals are not usually an issue for other defined contribution plans in which future benefits are determined by the employers annual contributions.

One half of defined benefit plan participants in medium and large firms are covered by plans which offer some type of provision for post-65 service, whether in the form of credits for post-65 service, actuarial adjustments to the benefit earned at retirement, or both (table 1). About 45 percent of all plans surveyed credit post-65 service (although they make no actuarial adjustment to ensure that the present value of benefits received over retirement will be the same for later retirement ages even though life expectancies are shorter for those who retire later). Most participants receive credits for all years of service or for service to a maximum age and number of years. Seventeen percent of participants receive credits only to a specified maximum age or years of service. A small number receive credits based on a different benefit formula.

About 5 percent of plan participants receive actuarially adjusted pensions at delayed retirement. These adjustments increase the participant's pension payments so that the present value of the benefit at normal retirement age is the same as the value of the benefit at delayed retirement. If the actuarial increase fully reflects the shorter period the participant draws benefits, the participant receives the same lifetime benefits (the same present discounted value of benefits) at the delayed retirement age as at the normal retirement age even though that retiree's expected life span will be shorter. In other words, the participant does not lose any of the asset value of the pension annuity. Legislation currently being proposed would credit service to those working past normal retirement age but would not require that benefits be actuarially adjusted to ensure that their discounted value be equal or better to that received at normal retirement.

While half of all participants in medium and large firms receive some type of pension adjustment for post-65 employment, many elderly are employed by smaller firms. Nearly 28 percent of employees 65 and older participating in a pension plan are employed by firms with fewer than 100 employees compared to nearly 18 percent of those under age 65. Older workers are also more likely to be employed by smaller firms than younger workers (64 percent to 39 percent) although they are nearly as likely to be covered by a plan. A lack of information about the prevalence of post-65 accruals among these smaller plans will affect the accuracy of our estimates of the extent to which participants receive continuing accruals.

EMPLOYMENT AND PARTICIPATION: THE EFFECT OF POST-65 ACCRUALS

Whatever the size of firm providing employment, we know that relatively few elderly choose to work after age 65, and that this proportion has been declining steadily since Social Security was enacted 50 years ago. The labor force participation rate of men 65 and over has declined considerably, from

33.1 percent in 1960 to 16.3 percent in 1984. A recent study by the Department of Labor has shown that men born in each successive year between 1903 and 1923 have had lower labor force participation rates at practically every age from 55 to 74.[1] Among men born in 1903, 11.9 percent were no longer in the labor force by age 60. Among men born 20 years later, 28.4 percent were no longer working by age 60. The average age of workers receiving Social Security benefits has declined substantially since the beginning of the program. In 1940, men were first awarded Social Security retirement benefits at an average age of 68.8. By 1980, the average age of award for men was reduced to 63.9 years.

Among all workers 65 years of age and over (including the self-employed), only 1.2 million persons worked 1,000 hours or more during the year and had worked at least one year for their current employer. In general, ERISA requires that an employee who meets these criteria and is more than five years younger than the plan's normal retirement age must be included in the pension plan if one is offered.

Elderly employees with pension coverage often appear to be working for their career employer. Most older workers worked for their current employer more than three years and 80 percent worked for their current employer for more than five years. This latter group is most likely to be continuing with the same employer they worked for before age 65. Those who have worked less than five years for their current employer are likely to have changed jobs at or after age 65. Those changing jobs at or near retirement would not be affected by pending federal or legislative proposals, which provide pension accruals only for continuing employees. Those changing jobs at or near retirement could still be excluded from participation in the plan under the provisions of ERISA that allow employers to exclude employees hired within five years of the plan's normal retirement age.

Within a framework in which many may be still working at career employment, how many older workers would be affected by standards to require continued pension accruals on the worker's 65th birthday? Out of an estimated 365,000 nonfarm plan participants in the private sector in 1985, 182,000 are likely to be in plans that do not currently accrue benefits past 65 (table 2). Of these, only 151,000 are entitled to benefits. This relatively small group would be helped by post-65 accruals Those who are participating but have not qualified for vested benefits are unlikely to be affected since the most prevalent vesting standard under a defined benefit plan is 10-year cliff vesting. Those who are not vested at age 65 are quite unlikely ever to meet a 10-year vesting standard.

Out of 2.9 million workers 65 years of age and over, considerably less than 10 percent would benefit from post-65 accruals. Out of 25.2 million persons age 65 and over, less than 1 percent would benefit. In sum, a very small percentage of the population 65 years and older is likely to be affected by continuing pension accruals primarily because the majority of workers retire well before they reach that age. Since this is the case, the key statistical issue appears to be the effect of such accruals on the income of the future retirees affected, on labor force participation, and on the firms providing these benefits.

PARTICIPANT LOSSES AT LATER RETIREMENT AGES

Depending on the plan's provisions, an employee delaying retirement for two years can lose from 4 percent to 23 percent of the present value of accrued lifetime benefits compared to normal retirement unless the benefits are actuarially adjusted to make up for delayed retirement. An employee delaying retirement for five years can lose from 10 percent to up to half the value of pension benefits accrued at age 65 in present value terms because of the shorter payout period expected at later retirement ages.

The participant's losses are lowest in terms of the present value of lifetime benefits if the plan credits both additional service and salary increases in determining the amount of the pension benefit (table 3). This is what the EEOC and proposed post-65 pension accrual legislation would do. Proposed legislation does not demand that benefits be made actuarially "fair," that is, that retirees sustain no losses in present value terms no matter their retirement age. If service and salary increases are credited, the employee retiring at age 67 loses only 4 to 8 percent of the present value of accrued benefits, however, while the employee retiring at age 70 loses only 10 to 18 percent compared to the present value of benefits that would have been received had retirement taken place at the plan's normal retirement age. Without continued accruals, these losses are much larger.

If the plan credits only additional service and not salary increases, the participant's losses can range from 14 to 19 percent of present value of accrued benefits retiring at age 67, and 30 to 41 percent retiring at age 70 compared to retirement at age 65. Losses are greatest in present value terms if benefits are frozen at age 65 with no service credits and no actuarial adjustments. In this instance the participant can lose 19 to 23 percent of total benefits retiring at age 67 and 41 to 47 percent retiring at age 70 compared to the present value of benefits .

However, if individuals value their pensions correctly, they will retire when the present value of their pensions is at its highest. By this argument, those who have not retired at that point must have some other reason to continue their employment. They may particularly enjoy their work or they may receive other benefits which offset the decreased value of their pensions. If continued pension accruals change the age at which the present value of pension benefits peaks, more older workers can be expected to stay on the job. Unanticipated later retirement would reduce the pension costs to employers. But employer costs for other benefits may be higher for older workers. For instance, now that TEFRA requires that an employer's health plan be primary to Medicare payments, employer-provided health insurance costs and benefits are greater for older workers. In addition, life insurance costs are likely to be higher for workers past 65. Consequently, if post-65 accruals are made mandatory, younger workers could argue that older workers are receiving more than their fair share of compensation. More likely, employers could ease the pressure of other benefit costs for any particular older worker by reducing the salary share of compensation. As long as such adjustments are possible, the effect of continued accruals on the compensation package or on employment cannot be fully evaluated. Nevertheless, the employment effects are not likely to be large given the tendency towards earlier and earlier retirement. For instance, studies have show that even the recent 1983 Social Security provisions will not have much affect on retirement ages.

COSTS TO EMPLOYERS OF CONTINUED ACCRUALS

Since the present value of pension benefits differs according to retirement age, pension accruals for employees continuing to work after age 65 will not necessarily increase employers' pension costs compared to the costs they would have incurred had the worker retired at age 65. Of course, many economists suggest that pension plans are specifically designed with that result in mind in order to encourage retirement at normal retirement age. Post-65 accruals require increased employer pension costs for those employees working past normal retirement, however, compared to the pensions that would be paid without continued accruals.

It could be argued that requirements to continue pension accruals for additional service simply reduce the size of the employer windfall. Alternatively, it can be argued that the employer does not receive a windfall, but that the reduction in pension costs just compensates the employer for the higher costs of other benefits or for the reduced productivity of the older workers. In any case, abstracting from plan practices, employer costs for added accruals for those retiring past normal retirement age can be calculated under several reasonable assumptions to produce a range of cost estimates on a nationwide basis assuming that the late retirees continue to retire at the same expected age.

EBRI's October 1984 Issue Brief provided an estimate of post-65 accrual costs under the assumptions that the average wage for elderly workers is just under $14,000 and that the average pension costs is about 8 percent of payroll. This provides a minimum accrual cost of $280 million per year. EBRI estimates presented in The Changing Profile of Pensions in America indicate higher costs. In these estimates pension costs are estimated to be nearly four times as high for workers age 65 to 69 as they are for those age 45 to 49.[3] Pension costs for employees age 65 to 69, including post-65 accruals and actuarially equivalent benefit increases, are more than 20 percent higher than those needed for workers age 60 to 65. Assuming defined benefit plan contributions of 5 to 10 percent of earnings, estimated actuarial costs for 1985 range from $638 million to $1.3 billion (table 2).

These costs could be less in practice. About 55 percent of defined benefit plans are integrated with Social Security; contributions for older workers earning below the Social Security taxable maximum would be smaller. Other plans limit the number of years of credited service allowed and may have maximum benefit provisions. These practices would also tend to lower costs. Even given these provisos, contributions for post-65 accruals could total $1 billion in 1985 or only about 1.5 percent of the $65 billion in pension contributions made by private-sector employers in 1983. Whether additional contributions would be made by any particular plan would depend upon how retirement ages were factored in before accruals were required and whether actuarial study indicated that retirement age should be treated differently after post-65 accruals were required. Actual dollar contributions would probably not have to be increased for plans that never anticipated anyone working past normal retirement age.

CONCLUSIONS

Compared to the 1984 Retirement Equity Act, post-65 accruals benefit fewer workers at potentially higher additional contribution costs.[4] Increased pension benefits may be quite important to workers affected by the legislation increasing the present discounted value of lifetime benefits by 15 to 50 percent. Those receiving post-65 accruals would have their retirement income enhanced when they left the labor force. Some workers might decide to retire at later ages because of this benefit inducement. The impact of continued accruals for particular workers would depend on salary, years of service, number of years working after normal retirement age and the particular provisions of the plan. While the cost of this legislation may be high for some employers who employ a large percentage of workers age 65 and over, on a nationwide basis, using the highest or lowest of our estimates, additional costs are minimal.

Because relatively few employees are affected since most older workers have retired by age 65, it could be argued that the legislation ought to be evaluated primarily from a civil rights perspective. Nevertheless, the secondary effects of post-65 accruals could lead to a decrease in the salaries of some workers over age 65. Salary reductions would probably be implemented through reduced salary increases at salary review time. Furthermore, if the incentives towards later retirement found in the 1983 Social Security Amendments were eventually ratified by private-sector initiatives which also encouraged later retirement for workers in the baby boom, the number of persons receiving post-65 accruals could increase over the next 20 to 40 years. In its debates over this issue, Congress will have to balance the advantages to older workers from requiring accruals against these potential disadvantages. EBRI is currently developing a monograph on older workers which we will share with you upon completion.

NOTES

1 See Phillip L. Rones, "Using the CPS to track retirement trends among older men," Monthly Labor Review, 1985, pp. 46-49.

2 As reported in the May 1983 EBRI/Health and Human Services Current Population Survey pension supplement.

3 The primary methodological differences are in the estimated number of participants affected by the provision and the percentage of salary needed to fund the pension. More participants were assumed in our first estimate at lower per participant costs.

4 See EBRI Issue Brief #39 (February 1985) for an analysis of the effects of the Retirement Equity Act.

Table 1

Full-time Participants in Private Pension Plans by Provision for Service Credit After Age 65, in Medium and Large Firms, 1984

Provision	Percent of Participants
No adjustment	50
Pension deferred with no change in amount	49
Pension begins at age 65	1
Pension adjusted actuarially	6
Pension deferred only	5
Pension deferred and all service credited[b]	1
Service credited to maximum age or service	a
Credit for service with no actuarial increase	45
Pension deferred and increased by percent for each additional year of service[c]	2
All service credited[b]	25
Service credited to maximum age	17
Service credited to maximum years of service	a

Source: EBRI tabulations based on U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1984, 1985, p. 53.

[a] Less than 0.5 percent.

[b] Credit computed under the plan's regular benefit formula.

[c] Credit computed by a method that is not part of the plan's regular benefit formula.

Table 2

Estimated Effect of Post-65 Pension Accruals
1985

	Older Workers[a]
Affected workers	
Participants	182,000
Entitled to benefits	151,000
	Illustrative Estimates of Annual Costs[b] (millions of dollars)
At average annual cost of[c]	
$3,500 per participant	$638
$7,000 per participant	$1,276

SOURCE: EBRI estimates based on May 1983 EBRI/HHS CPS Pension Supplement and estimates of actuarial costs from Anna M. Rappaport and Malcolm M. Morrison, the Costs of Employing Older Workers (Washington, D.C.: Employee Benefit Research Institute and U.S. Senate Special Committee on Aging, 1984).

[a] According to the Bureau of Labor Statistics one-half of all plans credit service after age 65 but without an actuarial increase so benefits do not increase after age 65. Estimates of those affected by post-65 benefit accruals are equal to 50% of the imputed number of all private sector nonagricultural wage and salary workers participating and entitled to retirement benefits under a pension plan in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment for older workers over the figures for 1983.

[b] Does not include administrative costs.

[c] Derived from Appendix Exhibits A-1, A-6, and A-11, Anna M. Rappaport and Malcolm M. Morrison, the Costs of Employing Older Workers (Washington, D.C.: Employee Benefit Research Institute and U.S. Senate Special Committee on Aging, 1984). Based on approximate pension costs for participants aged 65 to 69 in defined benefit plans earning between $10,000 and $25,000 with employer contributions of 5 percent and 10 percent of total salary costs. Dollar values equal the number of participants affected times the per-participant cost.

Table 3

Percent of Lifetime Pension Benefits
Lost Due to Delaying Retirement
until Age 67 and 70
under Alternative Plan Provisions

Plan Provision	Age at Retirement 67	Age at Retirement 70
	Lifetime Pension Benefits Lost (Percent)	
Benefits frozen at age 65	19 to 23	41 to 47
Additional service credited only	14 to 19	30 to 41
Additional service and salary increases credited	4 to 8	10 to 18
Benefits actuarially adjusted	0	0

Source: EBRI calculations based on data presented in "Equal Employment Opportunity Commission Staff Analysis on Proposal to Require Pension Accrual After Normal Retirement Age," Daily Labor Reporter, June 27, 1984.

Senator GRASSLEY. Again, I want to reiterate what I said to the previous panel; even though I might direct a particular question to a specific panelist, anybody else who wants to chime in, please feel free to do so.

Obviously, we have been spending a great deal of time on the question of cost. It is probably one of the most central issues we have to deal with, and I have appreciated the perspectives on that question that this panel has provided. You have done very well at that, both from the perspective of the employee of not requiring post—65 accruals, and from the perspective of the employer, of requiring those post-65 accruals.

As far as the impact on employees is concerned, to me it seems that based on your statements, it would be reasonable to say that somewhere in the neighborhood of 130,000 to 150,000 employees could suffer reductions in the present values of their accrued lifetime benefits of up to 50 percent if their pension plans halt benefit accrual at age 65. Is that generally the consensus among the three of you?

Mr. LOSK. I believe that was Ms. Andrews' number, but that number would seem reasonable to me.

Senator GRASSLEY. Mr. Kalman?

Mr. KALMAN. It would seem reasonable, except the 134,000 that I mentioned reflected those who were in defined benefit plans. There are also 79,000 in defined contribution plans that are also affected by a freeze in benefits. However, some of those 79,000 also would be participating in defined benefit plans, so there is some overlap between the 79,000 figure and the 134,000 figure.

Senator GRASSLEY. Mr. Kalman, in his statement, said that benefits lost because employers do not grant full pension credit to employees beyond age 65 would amount to about $450 million. And from the perspective of the research you have done, Ms. Andrews, and from your expertise in this area, Mr. Losk, would you tend to agree with that or have any comment contrary to that?

Ms. ANDREWS. I would say we are essentially in the same ballpark, because all of our lower and upper estimates are around that range, and I think quibbling in that range is not particularly useful.

Mr. LOSK. Yes, I agree. I would not have information that would refute that number.

Senator GRASSLEY. Now to a point dealing specifically with my bill, the question I most frequently get thrown at me is how much will it cost employers. From each of your statements, I have the impression that the simple answer to that question is that there is not a simple answer to that question. In other words, if I were to put that question to 10 experts, I might get 10 different answers, and depending upon their assumptions and the way they approached the question, some might tell me that I would save money, some might tell me that no costs would be involved, and some might tell me that the costs would be as high as one and $1.3 billion.

With that in mind, I would like to ask what I regard to be a bottom-line question. Would you say that the post-65 accruals place an unreasonable burden on employers? In other words, would you say that on the basis of cost alone, present law should not be changed?

Mr. LOSK. I would say this, Mr. Chairman. There are two questions of cost in the bill. First, we are talking about continuing accruals for existing plan members. And for my frame of reference, the cost implications of that portion of the bill are not substantial.

The other question relates to participation of persons not currently required to participate in pension programs, and those are people who are hired within 5 years of normal retirement age. There is a cost there. I have no good feel for what that cost might be, whether it would be reasonable or unreasonable——

Senator GRASSLEY. Could I clarify that my bill only deals with post-65 accruals.

Mr. LOSK. OK. If we are talking only post-65 accruals, and not the participation issue, I would say there is no serious cost question.

Senator GRASSLEY. Yes; that is the point that we want your response to.

Mr. LOSK. Very good.

Senator GRASSLEY. Ms. Andrews?

Ms. ANDREWS. In terms of the cost of benefits, as I said, this is a very small proportion of total contributions and total benefits paid out. So, while I would not want to make any policy statement, I would stick by the statement that the costs are very small.

What none of us have discussed is any impact on administrative costs of changing plan provisions, and I have not studied this, and I do not know whether the administrative costs would affect any employers because they would have to amend their plans another time. I have not looked into whether this would affect some parts of the economy more than others.

Senator GRASSLEY. Mr. Kalman?

Mr. KALMAN. Yes, I would just reiterate what I mentioned were our general findings. And frankly, we found again that for those who are currently age 65 to 69, if there is no increase in the age 65 to 69 work force cost over a 20-year period, we estimate under one percent of total pension costs. And with increases in employment, the cost would decline. So I do not think that, based on our study, cost is going to be significant whether you consider that employment will remain unchanged for post-65 through 69 employees, or certainly, if employment increases in this age bracket.

Senator GRASSLEY. Ms. Andrews, you reached a conclusion that I would like to have you comment on, and that conclusion dealt with your estimate of the additional cost to employers and the fact that it is substantially higher than an earlier estimate made by EBRI due to an assumption that the cost of pension accruals for workers at age 65 through 69 is substantially higher than for younger workers.

Ms. ANDREWS. EBRI's later cost estimates are maximum estimates, assuming that plans do the most that they could possibly do for older workers. The most that plans could do would be to ensure that the value of a workers retirement benefit in terms of an asset was the same at 65 as it would be at a later retirement age, plus continue to accrue benefits earned between those two periods—for example, between 65 and 69. So these would be the maximum costs, the maximum benefits possible that the worker could receive if the plan did all it could in order to be as fair as possible in terms of the value of the benefit.

Senator GRASSLEY. I do not know whether Mr. Kalman and Mr. Losk have any comments on that point.

Mr. LOSK. No, I would not. I would just say that the outside range which has been described here is truly outside, and it is a rare plan that provides both the preservation of actuarial value and additional increases.

I would consider Ms. Andrews' outside number to truly be an outside number.

Mr. KALMAN. Yes; I agree. In our work, we dealt with two different scenarios, one where we would credit under a defined benefit plan service beyond age 65 only, and then under the other scenario, credit service but also credit salary after age 65.

I think those scenarios are what can be reasonably expected, and that is why we did not consider what Ms. Andrews used for her outside estimate.

Ms. ANDREWS. I might add that the latter estimates were developed in particular to compare to other types of policy proposals and to indicate that these costs are relatively small in comparison to other types of proposals that are not under consideration at this time. So they were developed in a slightly different framework, and that is why they are maximums.

Senator GRASSLEY. Those are the only questions that I have for you. I should also announce at this point, and it applies to the other witnesses as well, that you may get questions in writing from people who cannot be here because of conflicts and other committee meetings and if you receive such questions in writing, we would appreciate your responses in 15 days, and we will keep the record open for that purpose, and also for any additions or corrections you wish to make.

Thank you very much for your testimony.

Senator Grassley. Our final witness today is Mr. Jack Guildroy, a member of the legislative council of a very important organization in town that speaks for millions and millions of retired people, the American Association of Retired Persons. I welcome you to the subcommittee. It is no surprise to anybody in Congress that the AARP would have very important views on these issues, because your research and your policy decisions are well-respected here on the Hill.

So, would you proceed with your testimony—and I would like to say—just in case you were not here, that your entire statement will be put in the record as if you read it, and we will ask you to summarize.

STATEMENT OF JACK GUILDROY, MEMBER, NATIONAL LEGISLATIVE COUNCIL, AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY DAVID CERTNER, AARP LEGISLATIVE STAFF

Mr. Guildroy. Thank you very much, Senator.

My name is Jack Guildroy. I am a member of the National Legislative Council of the American Association of Retired Persons. Seated next to me is Mr. David Certner, a member of the AARP legislative staff.

AARP is the Nation's largest aging oraganization; it has over 20 million members. We appreciate this opportunity to testify on the unfair practice of ceasing pension accruals at age 65. Current regulations penalize older workers by allowing employers to freeze pension benefits for employees who work beyond age 65. The result is lower compensation to the older worker who continues working and eventually, a significant reduction in retirement income security.

To end this discriminatory practice, our association supports amending existing law to require that employers continue to accrue pension benefits for post-65 employees.

The Equal Employment Opportunity Commission has thus far failed in efforts to produce a new rule, despite EEOC's conclusion that current regulations are inconsistent with age discrimination law. And our association now believes that legislation is needed to swiftly put a halt to this unfair practice.

AARP believes that your bill, Senator, S. 1427, and H.R. 2700 of Representative Roybal, or H.R. 2712 of Representative Biaggi, which require pension accrual beyond age 65 will help promote fairness for older workers.

Now, the basic thrust of the Age Discrimination in Employment Act is to prohibit discrimination in employment on account of age in such matters as compensation and other privileges of employment. The 1978 ADEA amendments recognize the economic value of continued work and the inherent right of the individual to choose to work or to retire without discrimination due to age; they increase the earliest available compulsory retirement age to age 70.

The cessation of pension benefit accruals, however, still remains as a major disincentive for those employees who need or want to continue working beyond the normal retirement age, usually 65, even though they are protected from age discrimination until age 70.

Permitting an employer to halt pension crediting at age 65 gives a windfall to employers in two ways. First, an employer provides less compensation for older workers by not contributing to the plan on their behalf, and second, by suspending payment of the pension while the person is employed and by failing to provide an actuarial increase when retirement occurs, the employer will eventually pay a pension that is significantly less valuable.

A person who continues to work beyond normal retirement age because he cannot afford to retire will unfortunately find that retirement will always be unaffordable because the pension owed to him will never increase.

Nearly half of all employees now covered by pension plans will receive substantially diminished pensions if they choose to delay retirement and work past those plans' normal retirement age.

The EEOC has concluded that current law does not promote the stated purpose of the ADEA. Chairman Thomas has emphatically stated.

> The Commission believes that the former interpretation may have gone further than necessary, in that the interpretation permitted employers to deny benefits to employees working beyond the normal retirement age, based not on cost, but based exclusively on their age.

It is now over a year since the EEOC first completed a draft of the new proposed rule. It is also 6 years since EEOC began an exhaustive study and review of the former interpretive provisions. EEOC has indicated that the proposed rule will not be presented for review until at the earliest, August 30, 1986. We heard this morning it may be a few weeks earlier than that.

Older workers, however, do not have the luxury of time. Each year, tens of thousands are denied proper pension coverage, solely due to age. Today's older worker still faces a no-win decision when deciding whether to continue working. With the administrative process providing neither foreseeable relief nor a strong signal that current regulations cannot be relied upon, employers continue to freeze pension credits for employees at age 65. Legislation is sorely needed at this point to remedy this unfair and discriminatory treatment of older workers.

Cost considerations simply do not justify cessation of pension benefit accrual at age 65. Any increases in benefits due to such factors as salary increases would generally be offset by factors such as shorter life expectancy, interest earned on plan assets, and increases in preretirement mortality.

A recent study commissioned by AARP, soon to be released as a Senate Aging Committee print, concluded that requiring continued pension accruals would produce only minute increases in aggregate plan costs. We heard about it this morning from Mr. Kalman.

Moreover, if as expected, continued accruals lead to an increase in post-65 employment, aggregate plan costs may actually decrease. Continued employment would also produce significant gains in the Social Security Trust Fund and in Federal tax revenues. Of course, these effects would be secondary to the main effect of continued accruals, which is increased retirement income security for older persons.

In the scenario where there is no increase over present post-65 employment, aggregate plan costs as we have heard would increase only one-tenth of 1 percent in the first year. And the greater the percentage of older workers continuing to work, the smaller the cost increase. If the number of workers age 65 and above increases by 25 percent, aggregate plan costs would increase by only four-tenths of 1 percent after 15 years. And if 50 percent continued to work beyond age 65, plan costs will actually decrease over time.

Perhaps the most easily understood aspect of post-65 pension accruals is the impact on the Social Security System, where continued accruals can be expected to save Social Security—with a 25 percent increase in post-65 employment—about $739 million annually.

To conclude, let me just stress what I have been saying all along: Since EEOC has been unable to complete action on its own definitive mandate, AARP strongly supports and urges the immediate consideration of legislation to require post-65 pension accruals.

Thank you, Senator.

[The prepared statement of Mr. Guildroy follows:].

AARP

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

Subcommittee on Aging
of the
Senate Committee on Labor and Human Resources

on

POST-65 PENSION BENEFIT ACCRUAL

(S. 1427, H.R. 2700 and H.R. 2712)

October 17, 1985

Presented by:

Jack Guildroy
National Legislative Council

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700
Vita R. Ostrander *President* Cyril F. Brickfield *Executive Director*

I. Introduction

The American Association of Retired Persons, the nation's largest aging organization with over 20 million members, appreciates this opportunity to testify on the unfair practice of ceasing pension accruals at age 65.

Current regulations, which allow employers to forego increasing pension benefits for employees who work beyond age 65, result in lower compensation to the older worker who continues working and eventually to a significant reduction in retirement income security.

To end this discriminatory practice, the Association supports amending existing law to require that employers continue to accrue pension benefits for post-65 employees. Consistent with this position, AARP has for several years urged the Equal Employment Opportunity Commission (EEOC) to replace current regulations with a new rule requiring accrual beyond age 65.

Having failed in efforts to thus far produce a new rule, despite EEOC's conclusion that current regulations are inconsistent with age discrimination law, the Association believes that legislation is needed to swiftly put a halt to this unfair practice. AARP therefore strongly supports legislative efforts to end this current unfair practice, and believes that S. 1427 (Sen. Grassley), H.R. 2700 (Rep. Roybal), and H.R. 2712 (Rep. Biaggi), which require pension accrual beyond age 65, will help promote fairness for older workers.

II. The Problem

In enacting the Age Discrimination in Employment Act (ADEA) in 1967, Congress attempted to provide fair treatment for the older worker without overburdening the employer. The basic thrust of the ADEA is to prohibit discrimination in employment on account of age in such matters as hiring, job retention, compensation and other terms, conditions and privileges of employment. Its main purposes are:

1) to promote employment of older persons based on their ability rather than age, and

2) to prohibit arbitrary age discrimination in employment.

Unfortunately, both of these purposes continue to be frustrated by the current practice of halting pension crediting for employees who continue working beyond age 65.

The 1978 ADEA amendments increased the earliest allowable compulsory retirement age to age 70. While the 1967 Act recognized and accepted existing retirement practice of age 65 as the upper limit, the 1978 amendments specifically rejected past practice and added five years to the mandatory retirement age. Two major reasons lay behind the change:

1) the economic value of continued work, and

2) the inherent civil right of the individual to choose to work or retire without discrimination due to age.

The Senate Report of the Human Resources Committee on the 1978 amendments noted: "The committee believes that as a matter of basic civil rights, people should be treated in employment on the basis of their individual ability to perform a job rather than on the basis of stereotypes about race, sex or age." [S. Rep. No. 95-493, 95th Cong., 1st Sess. (1977), reprinted in (1978) U.S. Code Cong. and Ad. News, at 505-6.] The Senate Report also stressed the economic value of continued work, noting that "severe injustices" could result since "for many, retirement income from public or private sources is unavailable or inadequate to support a comfortable existence". The report added that "maximum freedom of choice should be given to employees in deciding when to retire", and concluded: "Although the committee does not suggest that workers should be required to continue working beyond 65, this data suggests we should not discourage those older Americans who wish to continue working." [Id, at 596-7 (emphasis added)] The cessation of pension benefit accruals, which treats the older worker in a discriminatory manner, still remains as a major disincentive for those employees who need or want to continue working beyond the normal retirement age (usually 65) even though they are protected from age discrimination until age 70.

Due to concern over cost differences in employee benefit plans associated with older workers, Congress in 1967 enacted a section [29 U.S.C. §6234 (f)(2)] which allows for cost differences to be reflected in employee benefit plans which are "not a subterfuge to evade the purposes" of the ADEA. While this section is designed to prevent employers from incurring greater costs in hiring older workers, it also now allows a substantial windfall to employers at the expense of older workers who continue working beyond their pension plan's normal retirement age.

Permitting an employer to halt pension crediting at age 65 gives a windfall to employers in two ways. First, an employer provides less compensation for older workers by not contributing to the plan on their behalf. Second, by suspending payment of the pension while the person is employed and by failing to provide an actuarial increase when retirement occurs, the employer will eventually pay a pension that is of significantly less value. A person who continues to work beyond normal retirement age because he/she cannot afford to retire will unfortunately find that retirement will always be unaffordable because the pension owed to him/her will never increase.

Current regulations (initially promulgated by the Department of Labor)--which allow employers to freeze the pension benefits of employees who work beyond their plan's normal retirement age--are thus contrary to the stated goals and purpose of the ADEA. Nearly half of all employees now covered by pension plans will receive substantially diminished pensions if they choose to delay retirement and work past the plan's normal retirement age; larger corporations are more likely to freeze benefits. Those employees whose pension credits are frozen at age 65 are, in essence, treated differently from all other employees. As a form of compensation, the older employee clearly receives less than his/her share from his/her employer. Consequently, the older worker is faced with a losing choice when making a retirement decision. This interpretation effectively discourages many older workers who wish to continue working.

III. Current Regulations: Status of Proposed Change

The Equal Employment Opportunity Commission, which assumed responsibility for regulations in this area, has examined the current conflict between Labor's regulations and the ADEA. On June 26, 1984, EEOC voted to rescind Labor's interpretation, concluding that current law did not promote the stated purpose of the ADEA. Chairman Thomas emphatically stated: "The Commission believes that the former interpretation may have gone further than necessary..., in that the interpretation permitted employers to deny benefits to employees working beyond the normal retirement age, based not on cost, but based exclusively on their age." [Oversight Hearing on the Employee Retirement Income Security Act: Requiring Pension Accruals for Work Beyond Normal Retirement Age before the Subcommittee on Labor-Management Relations of the House Committee on Education and Labor, 98th Cong., 2nd Sess. 3 (Sept 5, 1984)(statement of Clarence Thomas)].

Despite the June 1984 vote, the EEOC did not further proceed officially until March 5, 1985, when the Commission, by unanimous vote, again reaffirmed that current accrual rules are inconsistent with age discrimination law. At that time, the EEOC proposed to rescind current regulations and to promulgate a new rule requiring pension accrual beyond age 65.

It is now over a year since the EEOC first completed a draft of the new proposed rule. It is also six years since EEOC began "an exhaustive study and review of the former interpretive provisions." (Thomas statement, Id, at 2). EEOC has indicated, however, that the proposed rule will not be presented for review to the Office of Management and Budget until, at the earliest, August 30, 1986. Even at this point, the fate of the new rule remains in doubt. (Although the Commission has had the pension accrual issue under review for 5 years, and despite EEOC's use of existing cost studies in drafting a new rule, the Commission has seen fit to engage in a lengthy bidding process to contract out for an Economic Impact Statement (EIS). According to the EEOC, the EIS will not be completed until August 30, 1986).

Older workers, however, do not have the luxury of time. Each year, tens of thousands are denied proper pension coverage solely due to age. Today's older worker still faces a no-win decision when deciding whether to continue working. With the administrative process providing neither foreseeable relief nor a strong signal that current regulations cannot be relied upon, employers continue to freeze pension credits for employees at age 65. Legislation is sorely needed at this point to remedy this unfair and discriminatory treatment of older workers.

IV. Cost Analysis - Burden on Employers is Insignificant

The 1979 Labor Department Interpretive Bulletin, which deals with Section 4(f)(2) of the ADEA, states that "the legislative history (of Sec. 4(f)(2)) indicates that its purpose is to permit age-based reductions in employee benefit plans where such reductions are justified by significant cost considerations...," and that "where employee benefit plans do meet the criteria in Section 4(f)(2), benefit levels for older workers may be reduced to the extent necessary to achieve approximate equivalency in cost for older and younger workers." 44 Fed. Reg. 30658 (May 25, 1979). The Labor Department regulations thus attempted to mollify employers' fears of substantial cost increases, but in effect produced an unintended windfall for the employers at the expense of the older worker.

Cost considerations simply do not justify cessation of pension benefit accrual at age 65. A response by the Assistant Secretary of Labor for Employment Standards to questions posed by Senators Javits and Williams regarding the cost of post-65 accruals recognized that if these accruals were made, plan costs would not increase significantly. The letter from Assistant Secretary Donald Elisburg (reprinted at 1978 U.S. Code Cong. and Ad. News, at 519) stated in part:

> "It is possible that certain plans, such as those which provide for the accrual of benefits after normal retirement age, will not experience (plan) savings. However, there will be no significant cost increase to these plans. Any increases in benefits due to such factors as salary increases after employees have attained normal retirement age would generally be offset by factors such as the shorter life expectancy of employees upon retirement after normal retirement age, interest earned on plan assets during the period between normal retirement age and the age at which employees actually retire, and increases in pre-retirement mortality."

A recent study commissioned by AARP, soon to be released as a Senate Aging Committee print, concluded that requiring continued pension accruals would produce only minute increases in aggregate plan costs. Moreover, if, as expected, continued accruals lead to an increase in post-65 employment, aggregate plan costs may actually decrease. Continued employment would also produce significant gains in the Social Security trust fund and in federal tax revenues. Of course, these effects would be secondary to the main effect of continued accruals - increased retirement income security for older persons.

The study indicates that plan sponsors' fears of higher pension costs resulting from mandatory accruals are unfounded. In a worst-case scenario (no increase in post-65 employment), aggregate plan costs would increase by only one-tenth of one percent in the first year, and level off at nine-tenths of one percent after fifteen years if full accrual of pay and service is required.

The greater the percentage of older workers continuing to work, the smaller the cost increase. If the number of workers age 65 and above increases by 25 percent, aggregate plan costs would increase by only one-tenth of one percent in the first year and only four-tenths of one percent after 15 years. If 50 percent continue to work beyond age 65, plan costs will actually decrease over time because of the deferral of pension benefits.

Perhaps the most easily understood aspect of post-65 pension accruals is its impact on the Social Security system. For every employee who defers retirement beyond age 65, the Social Security trust fund benefits in two ways. Most important, the delayed payment of Social Security benefits results in substantial permanent savings to the Social Security system. (While delayed benefits are increased by 3 percent for each year delayed, this increase does not match the savings recognized by having the increased benefits paid over a shorter time span). Second, employers and employees continue to contribute, in the form of payroll taxes, to the trust fund.

Continued accruals can be expected to save Social Security, with a 25 percent increase in post-65 employment, about $739 million annually.

V. Cost Analysis -- Employees Lose Substantial Benefits

Non-accrual of pension benefits for workers who defer retirement enables a plan sponsor either to make reduced contributions during an employee's lifetime or to recognize a windfall upon the completion of benefit payments to the deferred retiree. In both cases, the retirees pension benefits are substantially reduced. For the purposes of illustration, assume that an employee's benefit amount is determined by a formula of one percent x highest five-year salary x years of service. (This typical plan formula is maintained for over one-half of all defined benefit plan participants.) A 65 year old employee with 25 years of service and a $20,000 average salary would be entitled to a pension of $5,000 a year. Assuming a remaining life expectancy of about 17 years and an eight percent interest rate, the present value of this benefit would be around $45,800.

When a plan freezes an employee's pension benefit at age 65, deferred retirement results in lower plan costs for that employee. The pension is paid over a shorter period of time and has a decreased present value. In order to fund a $5,000 benefit for a 70 year old retiree five years in the future, only about $27,800 must be set aside at age 65. When compared to the $45,800 needed to fund a 65 year old retiree's pension, it is clear that deferred retirement coupled with non-accrual allows the employer to lower plan contributions in anticipation of deferred retirement.

For plans which do not lower contributions in anticipation of deferred retirement, the paying of non-accrued benefits results in a windfall after the benefits are paid. During five years of deferral, the principal needed to fund a $5,000 benefit ($45,800) will, at eight percent, increase to about $67,300. The plan can then pay $5,000 a year to the retiree; and if that retiree lives for 13 years (the average life expectancy), the plan will receive a significant sum back after the retiree's death.

The practice of freezing pension accurals is particularly unfair in light of the fact that an employer can provide accrued benefits without incurring significant costs. One common means of increasing retirement benefits for employees who work past age 65 is to continue crediting their years of service and/or salary increases in their benefit formula. Over 40 percent of plan participants are covered by such plans. According to our earlier benefit formula, in a plan which credits post-65 service, a 65 year old employee with 25 years of service and a $20,000 average salary who works for five additional years would be entitled to a $6,000 benefit upon retirement at age 70, a 20% yearly benefit increase. While the employee gains through the crediting of service for post-65 work, this gain poses no difficulty to the employer. The cost to the employer of funding a $6,000 annual benefit for a 70 year old retiree is only $33,300, when that person is 65. The plan incurs no increased costs, because had the same person retired at age 65, the employer would have incurred cost of $45,800. However, the practice of crediting service provides a substantially more valuable benefit to the retiree.

A second means by which plans increase retirement benefits is by actuarial adjustment, a process through which compound interest earnings and a reduced life expectancy combine to substantially increase the benefit payable. For example, the present value of a $5,000 a year benefit payable at 65 ($45,800) would increase to $67,300 in five years. This amount could purchase an annuity paying the retiree $8,255 for the rest of his life, which represents a benefit increase of nearly 65 percent.

Employees are entitled to the full value of their pension at the plan's normal retirement age. The fact that some employees choose to defer retirement does not justify providing them with a pension of substantially decreased value. Freezing of the benefit at a specified age is both illogical, when viewed in light of the basic plan purpose, and unfair when understood to require little, if any, cost increase. Given the particular importance of an adequate pension for the retiree, this benefit cut can be extremely harsh.

VI. Consistent With ERISA

Proponents of maintaining past interpretations allowing cessations of benefit accrual may argue that the Employee Retirement Income Security Act (ERISA) requires such an interpretation. The Association believes that amending the ADEA to require pension accrual will not be inconsistent with ERISA.

ERISA, enacted in 1974, is subsequent to the ADEA prohibitions orginally enacted in 1967. There is nothing in ERISA or its legislative history that indicates the ADEA is to be affected.

Second, ERISA and regulations concerning cessation of benefits at a normal retirement age are merely permissive in nature, and as such would not conflict with ADEA requirements to continue pension accrual beyond the normal retirement age.

The Association believes, however, that amending both ERISA and the ADEA will be the most efficient way to correct the current inequity. Clarifying the law in both areas will resolve current questions regarding past legislative intent and prevent unnecesary litigation.

VII. Conclusion

Prohibiting employers from discontinuing pension benefit accruals at the normal retirement age will accomplish the following:

1) enhance implementation of the ADEA by promoting employment of older persons and prohibiting age discrimination in benefits;

2) advance individual civil rights and fundamental notions of fairness by treating the older worker as an individual and not as a member of a disadvantaged class;

3) further the purpose of pension plans by adding to the retirement income of elderly persons at little or no cost to the employer; and

4) result in potentially substantial savings to the Social Security trust funds.

All four goals are consistent with the purpose behind federal public policy in the area, and all serve to insure fair and equal treatment of the elderly worker.

Not only is the failure to accrue pension benefits inequitable to the older worker and a windfall to the employer, but it creates a perverse incentive to retire. Despite employees' needs or desires to maintain active employment, freezing of pension benefits at age 65 creates a substantial employment penalty. This is contrary to both the ADEA and the 1983 Social Security amendments. Because the efficient use of resources dictates that policy be designed to encourage people to continue to work, and because the encouragement here would lead to greater retirement benefits at little or no cost to the employer, AARP urges that the cessation of pension benefit accruals for those who work beyond the normal retirement age be prohibited. Since EEOC has been unable to complete action on its own definitive mandate, AARP strongly supports legislation to require post-65 pension accrual. We urge immediate consideration of S. 1427, H.R. 2700, and H.R. 2712 to remedy the inequity currently faced by older workers.

Senator GRASSLEY. Well, let me thank you for the support of the legislation. Along that line, if there is any change in the legislation, I would want you and your organization to be aware of it as it winds its way through the process. So I would invite you—and of course, we will take the initiative as well—to keep in touch with us, because the support of your people is very important in helping us to get it passed.

I have just a few questions. The first deals with your estimation within the context of the ADEA. What role should the cost to employers of requiring post-65 accruals play in the determination of whether or not to change current policy?

Mr. GUILDROY. Cost, we believe, is a very important factor, but as the study that we commissioned reveals, the cost will be practically negligible. Further, as we have stated both in our oral testimony and in our written testimony, the greater the percentage of persons who continue to work beyond 65, if there is an accrual of pension benefits, the less the total cost will become.

Senator GRASSLEY. What is your estimation of the impact of current policy with regard to the employee's decision whether or not to keep working past age 65?

Mr. GUILDROY. Current policy, as described in ERISA, for example, we are opposed to. We would like to have that change. The policy as envisioned by EEOC, we approve of. It is only because EEOC has delayed, perhaps for good reasons, that we are urging legislation.

Incidentally, Senator, we feel very strongly, regardless of the costs involved, there are other items that must be considered. And we believe that they are a matter not only of philosophical importance; we also believe they are very practical. We believe very firmly that to do away with discrimination based on age also implies to do away with discrimination in pension benefits. This we hold to very, very firmly.

We are delighted to see the results of the report that this organization has done for us, the Mercer-Meidinger report. However, to be very honest, if the report concluded a different set of circumstances so far as costs were concerned, we still would feel that this must be effected legislatively since it is getting no place administratively.

Senator **Grassley**. The question that I was trying to get at is the extent to which you feel that present policy discourages or has any impact upon people's decision to work beyond 65.

Mr. **Guildroy**. Well, since present policy includes a statement that permits employers, if they wish, not to accrue benefits beyond age 65, we would like to see that overturned, we would like to see that changed. We do not want the policy to permit employers to stop the accrual of pension benefits beyond age 65. We feel that workers, regardless of their age, should enjoy the same accrual of pension benefit.

Senator **Grassley**. Then, from that standpoint, you feel that it does discourage people from working beyond 65?

Mr. **Guildroy**. Yes, very much so. I would like to differ with some of the testimony that you have heard this morning. My understanding is that EEOC gets more mail, and perhaps some phone calls—certainly, AARP gets much mail—but more importantly, EEOC gets more mail on this particular issue than any other issue that it deals with, whether it involves sex or race or age. This particular issue of stopping pension benefits beyond age 65 is the most important issue that EEOC faces, if one judges on the basis of communications to it from workers.

Senator **Grassley**. OK. Mr. Guildroy, that completes my questioning. Thank you specifically for your contribution to this, and your counsel, all the panels, and all the participants in this hearing, particularly those who just came to listen and to participate that way.

Mr. **Guildroy**. Thank you, Senator.

[Additional material supplied for the record follows:]

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
1800 Massachusetts Avenue, N.W. Washington, D.C. 20036/202-857-9500

October 28, 1985

The Honorable Charles E. Grassley
United States Senate
Committee on Labor and Human Resources
Subcommittee on Aging
SH-404 Hart Building
Washington, D.C. 20510

Pension Accruals for Older Workers

Dear Mr. Chairman:

On behalf of the National Rural Electric Cooperative Association and its members, I am submitting today with this letter a written statement giving our comments on the proposal by the Equal Employment Opportunity Commission to mandate the accrual of pension benefits after normal retirement age. Our perspective is that of a trade association providing and administering employee benefits for its employees and employees of its members for some 40 years. I hope they will be of some help to you in developing a fair hearing record.

We appreciate your calling these hearings on what is a difficult area of labor and retirement policy.

Cordially,

Martin D. Wood, Director
Retirement, Safety & Insurance

Enclosure

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
1800 Massachusetts Avenue, N.W. Washington, D.C. 20036/202-857-9500

STATEMENT OF THE
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
FOR THE HEARINGS
ON
PENSION ACCRUALS FOR OLDER WORKERS
BEFORE THE
SUBCOMMITTEE ON AGING
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

OCTOBER 18, 1985

Mr. Chairman and members of the Subcommittee.

My name is Martin D. Wood. I am the Director of the Retirement, Safety and Insurance Department of the National Rural Electric Cooperative Association (NRECA) and the Administrator of the various welfare and pension programs sponsored by NRECA for its members. NRECA is the national service organization of the approximately 1,000 rural electric systems operating in 46 states. These systems bring central station electric service to approximately 25-million farm and rural individuals in 2,600 of our nation's 3,100 counties. Our various programs provide pension and welfare benefits to over 130,000 participants and their dependents in those localities.

NRECA sponsors and maintains a master, defined benefit pension plan (the "R&S Program") in which 863 rural electric systems participate, providing basic retirement security to over 42,000 employees. We are pleased that you have called these hearings because the proposed rule change by the Equal Employment Opportunity Commission (EEOC) will have a substantial cost to the retirement programs of our member systems and merits a full Congressional study. The rule involved is an EEOC administrative interpretation of section 4(f)(2) of the Age of Discrimination in Employment Act of 1967 (ADEA), which permits employers to cease pension accruals upon a participant's attaining the normal retirement age of his pension plan. On June 26, 1984 the EEOC voted to repeal its existing administrative interpretation and replace it with a rule requiring employers to provide pension accruals for employees who work beyond normal retirement age. The new proposed rule has not been made publicly available so our comments will therefore be limited to (1) a discussion of the effect the proposed rule will have on the basic retirement plan of over 80 percent of the rural electric systems of America and (2) a general discussion of how the issues involved should be resolved.

1. The Proposed Rule will have a Substantial Cost. We understand that the proposed rule will require pension accruals past normal retirement age of the plan regardless of the additional cost of such accruals. Such a change will add a substantial cost to the defined benefit plans of the majority of rural electric systems participating in the NRECA sponsored R&S Program. The R&S Program provides for the individual election by each system of the normal retirement age of that system's pension plan. The systems may elect from among three normal retirement ages of age 65, age 62 or the earlier of 30 years of service or age 62. Each system has the further individual election of either ceasing benefit accruals upon a participant's attaining the system's normal retirement age or continuing benefit accruals until the participant actually retires. Of the 863 systems adopting the R&S Program roughly 52 percent have elected to provide accruals only to normal retirement age and 48 percent have elected to provide accruals until actual retirement.

For the 52 percent of rural electric systems that presently cease pension accruals at normal retirement age, the EEOC proposal will involve a substantial increased cost for the funding of pension benefits. The R&S Program includes a feature that allows every participant to begin receiving benefits at his election upon attaining the normal retirement age of the system at which he is employed, without retiring or terminating employment. The sponsoring system has no choice in accepting this plan provision at this time. Therefore any employee may upon attaining the normal retirement age of his system's pension plan, receive his pension benefits, continue to work and draw his salary from the rural electric system at which he is employed.

Inherent in the acturarial rational describing no significant increased costs for mandatory post-retirement accruals is the concept that benefit payments do not commence until actual retirement. Under this assumption the benefits accrued prior to the normal retirement date are not paid until the time of actual retirement. This delay represents foregone benefit payments and may imply a longer funding period. The savings it represents helps to offset the increased cost of additional accrued benefits and increases in final pay recognition with respect to pre-normal retirement age service.

However, in a pension plan that allows participants to draw benefits without actually retiring (such as the R&S Program), these assumptions are not correct. Since there is no offsetting decrease in the value of the benefit (which there would be if participants did not have this election), the cost of additional pension accruals must be charged against the cost of the R&S Program. A dollar of accrual for a participant at or beyond normal retirement age is significantly more costly than the same dollar of benefit accrual for a younger plan participant. While the exact overall cost cannot be projected without an actuarial analysis, we can say that the EEOC proposal will result in a substantial net additional cost to the R&S Program.

The EEOC proposed rule may have other, unintended results in our industry. The typical rural electrical worker is engaged in a physically demanding job, involving climbing electrical poles and the manipulation of heavy and dangerous machinery and wire. The focus of the retirement program is accordingly to provide a benefit at an early age because the typical worker cannot perform such physical activity at an advanced age. Mandating the continued accruals past normal retirement age would probably not greatly benefit the working force because most rural electric workers would not delay retirement. However, management and office staff, which does not perform such physical labor, may delay retirement to obtain additional pension accruals. Therefore the EEOC proposal might have the effect of skewing overall pension benefits of rural electric systems towards office and managerial employees.

2. The EEOC Proposal Should be Resolved by Congress. Admittedly the issue raised by the EEOC proposal is

difficult for it intertwines questions of cost and fairness, employment policy and an aging population, and the intent of Congress. As you are also well aware, section 4(f)(2) of ADEA provides that it is not a violation of ADEA to observe the terms of a bona fide retirement plan. A retirement plan is clearly permitted by the Employee Retirement Income Security Act of 1974 (ERISA) to cease benefit accruals at the plan's normal retirement age. Therefore there is clearly a conflict between the provisions of ADEA and ERISA if the EEOC proposal is adopted. Such a conflict should be mediated by Congress.

We do not necessarily feel that the correct rule should be that pension accruals continue to actual retirement age or that pension accurals cease at normal retirement age. That issue may be debated elsewhere, or at another time. We do feel however that the proposed EEOC rule is an important change in the structure of retirement plans and that in view of the conflicting policy considerations any change should come through Congressional action and not by action of the EEOC, which has a mandate to advocate only one of those conflicting policies.

STATEMENT OF DAVID M. WALKER
DEPUTY ASSISTANT SECRETARY OF LABOR
TO THE SUBCOMMITTEE ON AGING
OF THE SENATE LABOR AND HUMAN RESOURCES COMMITTEE

The Department of Labor appreciates the opportunity to present the Administration's views on proposals to require continued pension benefit accruals after a plan's normal retirement age.

Two laws currently govern benefit accruals after a pension plan's normal retirement age: the Employee Retirement Income Security Act of 1974 (ERISA) and the Age Discrimination in Employment Act of 1967 (ADEA). ERISA is the primary law which regulates our nation's private pension plans. Although ERISA includes many standards for pension plans, it does not specifically require benefit accruals for employees who work beyond the plan's normal retirement age. Under ERISA, employers may provide such accruals and many employers do.

ERISA does permit employers to exclude from defined benefit pension plan participation workers hired within 5 years of the normal retirement age. This exclusion was included in ERISA because of the increased cost and funding requirements for defined benefit plans of including workers who were already nearing retirement age. At the time ERISA was enacted, it was generally felt that requiring coverage of newly hired older workers would discourage their hiring.

The ADEA protects workers between the ages of 40 and 70 against discriminatory hiring and employment practices based on age. Under this law, older workers must generally be offered either the same benefits or benefits of equal cost to those offered younger workers. The one exception to this general rule is that pension plans are not required to provide additional benefit accruals to workers after the normal retirement age. This exception was explicitly stated in a 1979 amendment to the Department of Labor's Interpretative Bulletin on ADEA. The Department's interpretation was based on its understanding of Congressional intent when the ADEA was amended in 1978.

Since enactment of the 1978 ADEA amendments and the Department of Labor's 1979 interpretative bulletin, there has been concern that many workers who choose to continue employment past age 65 are not accruing additional benefits under their pension plans. This concern has been translated into pressure to change the interpretation of current law. The result is that Congress now has before it a number of bills which propose to change current policy by requiring that all private pension plans continue benefit acruals for workers after the plan's normal retirement age. One such bill is S. 1427 introduced by Chairman Grassley of this Subcommittee.

In addition to the bills before Congress, the Equal Employment Opportunity Commission, which assumed enforcement responsibility for the ADEA in 1979, voted in 1984 to amend the Department of Labor's previous interpretation of the 1978 amendment to ADEA. The EEOC proposed to: (1) rescind that portion of the 1979 interpretative bulletin that permits employers to stop making pension benefit accruals past an employee's normal retirement age and (2) issue new regulations indicating that such benefit accruals are required under ADEA.

The Administration has not yet taken a position on either the EEOC proposal or the proposals before Congress. The Administration believes these proposals have significant implications for both equal employment and national pension policies and that careful and thorough analysis is needed before action is taken.

The Administration is very concerned that this Subcommittee and others who participate in these important policy deliberations be sensitive to the voluntary nature and the complexity of our private pension system. Currently under our voluntary private pension system, the primary pension benefit is most often provided through a defined benefit plan. For these plans, achieving equity for all groups of workers, while maintaining enough flexibility to assure that employers have sufficient incentives to provide adequate retirement benefits, involves complex trade-offs. The Administration feels that these trade-offs must be carefully considered and debated based on adequate information regarding the current complex structure of defined benefit plans and the probable responses of employers when they are required to revise their plans.

A major objective of this Administration is to encourage the continued growth of the private pension system and expand coverage under it. Encouraging expansion of private pensions is particularly important and will become even more important as the baby boom generation ages and begins to place serious constraints on the public resources available for income security in retirement. Defined benefit plans, which currently provide 80 percent of private pension coverage, are an integral part of the current private system. Moreover, many workers and employers agree that these are the most appropriate means of providing income security during retirement. It is essential to protect employers' incentives for continuing these plans. This is particularly true for small business where pension coverage is severely lacking. The Administration is concerned that recent economic changes combined with a succession of changes in the law and further restrictions on these plans could discourage their growth.

The Administration is also very concerned that any change in the pension law achieve its intended result. This is particularly important when the civil rights of older workers are at issue as well as the rewards that will be available to them for their continued contributions in the workplace. The primary purpose of changing the current policy is to insure that older workers who choose to continue employment after age 65 are not adversely affected by their decision. However, based on current information, it is not clear that requiring benefit accruals after age 65 will accomplish this objective because of employers' potential responses to any cost increases.

Aggregate estimates of the potential increase in the costs to plans of providing post normal retirement benefit accruals vary from $300 million to over $1 billion annually. The distribution of costs to individual plans is not known. However, depending upon a particular plan's structure, its current funding assumptions and the number of employees who work past age 65, the short-run costs of an affected plan could increase significantly (by more than 10 percent according to one estimate) or by very little.

The Administration is concerned that in cases where short-run cost increases are significant, employers may react strongly to contain costs. New benefit accruals might be counterbalanced by adjusting the way service or salary is credited for calculating benefits. The employer could impose maximum limits on years of service credited under the plan or place other maximum limitations on benefits in order to control overall costs. Employers who currently permit workers who are hired within five years of the normal retirement age to participate in their defined benefit plan may choose to exclude these workers in the future. Even in cases where increased costs are not an important consideration, employers who are required to revise their plans may offset the policy change by making one or several of the above types of revisions.

Some of these changes could adversely affect the group of participants the proposed change in the law is designed to benefit. For example, the typical worker who retires after age 65 with a pension has over 20 years of service. Although many plans do not now place a limit on the number of years of creditable service, plans may respond to the change in benefit accruals rules by placing maximums on such years of service. Thus, many of those who continue working after age 65 would receive no credit for their additional years of work even though the rules for accruing benefits after the normal retirement age had been changed. Other changes in plan provisions, discussed above, could limit the access of older workers to pensions in the future. None of these changes would necessarily be in the best interests of older workers and, in fact, may have an adverse affect on the willingness of sponsors to create and maintain defined benefit plans.

One of the primary problems with the current cost estimates is that they are based on hypothetical data rather than on data on the characteristics of the actual workers affected and the specific plans that cover these workers. Thus, little is known about the distribution of short-run cost increases that will be faced by individual defined benefit plans. Given the range of possible adverse employer responses, the Administration is concerned that adequate data are not available on the actual cost for affected plans or the possible responses of plan sponsors. Moreover, even the small amount of data that is available has not yet been analyzed.

Slightly over half of all defined benefit plans voluntarily provide benefit accruals after normal retirement age. The remaining plans would need to be revised, and many plans might need to be restructured. In particular, it is not clear how some plans would be required to comply with a change in the law. This may be particularly true for plans that actuarilly adjust benefits after the normal retirement age or begin paying benefits at that age even if an employee continues to work. In addition, some types of integrated plans would probably not be able to comply without increasing benefits to all participants, not just those who continue to work after age 65. This would result in significantly increased costs to sponsors beyond the issue of concern.

The number of plans that would be affected and the types of circumstances under which they might have difficulty conforming with the change without major restructuring to remain tax qualified is not known. The types of plans that could be adversely affected by a change in the post-normal retirement age accrual rules need to be carefully studied and ways devised to avoid undue hardships before proceeding to change current law.

In addition to these policy concerns, the Administration is reviewing the legal basis of the EEOC's proposed interpretation of current law. The legislative history of the ADEA appears to support the current interpretation and therefore may be an obstacle to the EEOC proposal.

In summary, two fundamental questions need to be addressed by the Congress and the Administration. First, should current law be changed to require benefit accruals for all employees who continue working after their pension plan's normal retirement age? Second, if this change should be made, how best can it be accomplished? It is the Administration's view that before either of these questions can be answered and adequately debated, more information is required. In addition, any ensuing debate must be based on a careful balancing of older Americans' needs for equal employment opportunity and retirement income security in order to ensure that any related change is not counter-productive.

EEOC is currently undertaking a study to examine more fully the impact of post-age-65 benefit accruals on plans and plan participants. This study should provide at least some of the answers to the complex questions raised here and provide a better basis for further policy deliberations.

The Administration looks forward to sharing the results of this study and any other analyses undertaken on this issue with this Subcommittee and other interested members of Congress. We look forward to working with you to resolve the many complex issues involved in these important deliberations.

Senator **GRASSLEY**. We thank you all very much, and the meeting is now adjourned.

[Whereupon, at 10:40 a. m., the subcommittee was adjourned.]

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